

Proving Damages in Trademark Cases

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Proving damages in trademark litigation—typically lost profits or disgorgement of the defendant's profits—generally involves citing the infringer's sales of the infringing product. This article considers some ways to measure trademark damages, including lost profits due to diverted sales and/or price reductions, unjust enrichment, reasonable royalty, and increased costs, especially for corrective advertising.¹

Trademark law is mainly set up to protect the public; the commercial interest of the trademark holder is only a secondary concern.² Therefore, damages may not be explicitly considered. In contrast to other types of intellectual property (IP) litigation, the main objective of trademark infringement litigation may not be to recover damages. Also, trademark litigation, like any IP litigation, is expensive and risky. The American Intellectual Property Law Association (AIPLA) 2007 survey of litigation costs puts the risk at \$1 million to \$25 million and the median cost of IP litigation, including trademark litigation, at

a prohibitively high \$2.5 million. Discovery and attorney time are key cost drivers. To measure trademark damages, one needs to make sure detailed financial information is available on the parties involved and hire damages experts to conduct complex and credible damages assessments.

Requirements for monetary damages. Some courts require evidence of consumer confusion between the plaintiff's mark and the defendant's mark for recovery from infringement, including a monetary reward. Checklists are also often used to establish the likelihood of confusion, but these lists are not consistent among federal circuits. To be awarded damages, some courts may require more evidence than potential confusion, often including evidence of *bad faith or willfulness*. Bad faith can mean different things, including deliberate fraud, intent to cause confusion, counterfeit, and knowingly infringing on the mark holder's rights. If bad faith is established, the standard for measuring the amount of damages may not be as strict. The plaintiff still needs damages proof, but the basis is "reasonable inference."³ This means a plaintiff need not precisely measure damages, especially if the defendant fails to provide financial data, a tactic that does not preclude recovery. Also, courts may be more forgiving regarding the amount of damages if the plaintiff and defendant compete directly in the same market.

Measuring actual damages in trademark cases. A lost profit of the plaintiff is a standard

1 The discussion of lost profits in this article builds on the discussion in Stanley Stephenson, David A. Macpherson, and Gauri Prakash-Canjels' "Computing Lost Profits in Business Interruption Litigation: A General Model," *Journal of Business Valuation and Economic Loss Analysis*, May 2012.

2 This point is made in Glenn Perdue's "Determining Trademark Infringement Liability and Damages," *Crowe: Expert Perspective*, Volume 3, 2005, www.crowechizek.com; Ethan Horwitz's "Cost of Action vs. Damages in Trademark Infringement Actions in the United States," Open Forum Papers Monte Carlo, Nov. 3-6, 1999; and explained in *Getty Petroleum Corp. v. Bartco Petroleum Corp.* *J Ane JJ*, 858 F.2d 103, Sept. 1988.

3 George G Strong, "Damages Issues of Copyright, Trademark, Trade Secret, and False Advertising Cases." In *Litigation Services Handbook*, edited by Roman L. Weil, et al. John Wiley & Sons, 1995, Chapter 33.

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way to measure monetary recovery; however, calculating lost profits is not without challenges. Presumably, it should be simple to measure the lost sales the plaintiff would have made but for the infringement and then subtract incremental costs on those sales to determine lost incremental profits. Here are a few of those challenges:

- a. *Length of damages period.* Exhibit 1 shows a damages period in which expected profits (EP) and actual profits (AP) are well-defined. In practice, however, start and stop dates to the damages period may not be as clear.
- b. *Other factors.* The presumption in Exhibit 1 is that the decline of the actual profits is solely due to the actions of the defendant. However, the defendant will likely point to factors other than infringement, such as competition, product quality, overall economic conditions, and industry changes that could have accounted for at least a share of the decline in actual profits.
- c. *Lost profits due to fewer sales.* Profits are defined and measured as revenue (sales) less the costs and expenses incurred in generating those sales. This is a very general expression, and the damages expert needs to carefully consider the facts of the case to know which factors account for lost profits. To an economist, revenue (R) can be expressed as a product of price (P) and quantity (Q) sold. Costs (C) can be expressed as fixed costs (FC) and variable costs (VC).⁴ Therefore, it is important to keep in mind that profits can vary as a result of the variation in price, quantity sold, variable costs, and/or perhaps changes in extraordinary costs or other fixed costs.

$$(1) \text{ Profits } (\pi) = P * Q - VC - FC$$

4 Variable costs vary directly with quantity, whereas practitioners often assume fixed costs are unaffected by small changes in quantity sold. In addition, some situations may involve the incurrence of extraordinary expenses (E), which are considered part of fixed costs, FC, because these expenses do not vary with quantity.

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Exhibit 1. Damages Period When EP and AP Are Well-Defined

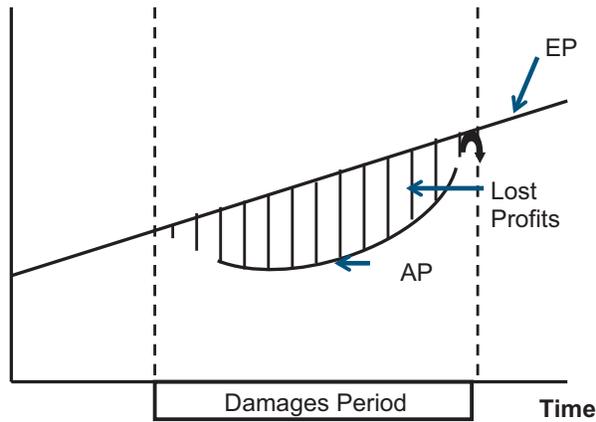


Exhibit 2

Lost profits as general model can be shown as follows.

Revenue but-for an “event” = R_B

And $R_B = P_B * Q_B$, where P_B is the price and Q_B is the quantity sold but-for the event.

Profits but-for the event = Π_B

$\Pi_B = R_B - F_B - V_B$, where F_B is the fixed cost and V_B is the variable cost (in the but-for world).

Actual revenue after the event = R_A

$R_A = P_A * Q_A$, where P_A is the actual price and Q_A is the actual quantity.

Actual profits after the event = Π_A

$\Pi_A = R_A - F_A - V_A$, where F_A is the actual fixed cost and V_A is the actual variable cost. Lost profits is thus expressed as

$$\Pi_B - \Pi_A = (R_B - R_A) - (F_B - F_A) - (V_B - V_A)$$

However, often damages experts who assess lost profits damages tend to ignore price considerations, and focus only on lost sales quantity (Q) and assume the “but-for” price equals the actual price.⁵

Key factors may not stay the same, especially if the trademark infringement continues for some time. What if there are changes in fixed costs, prices, or marginal costs of production or the trademark infringement impacts factors such as economies of scale? It is also possible that the firm incurs extraordinary expenses (E), perhaps due to extra advertising or other extra spending that does not vary directly with production (V) but adds to overhead.

⁵ See Foster and Trout, *op cit.* p. 9. Lost profits = lost revenue – avoidable variable costs. “Courts have generally agreed with economists on this proposition, and fixed costs (or overhead expenses in accounting terms) are nearly always ignored in measuring lost profits.” While relatively straightforward, a number of underlying assumptions are made when using this expression: if prices are assumed to have not changed, only quantity sold falls, overhead costs do not change, cost structures do not change, and no new costs are incurred because of the disruption or dispute. Damages assessments in trademark cases should not always make these simplifying assumptions, but should consider each factor as a potential source of lost profits.

d. *General case.* To provide a formal description of the generalized model, we next provide an equation that describes profits before and after an infringement. The derivation of the more generalized equation for determining the lost profits is provided in Exhibit 2.

In the most general case, damages suffered because of the infringement are estimated as $\Pi_B - \Pi_A$. Substituting the expressions for but-for and actual profits from the equations given in the Appendix, we have:

$$(2) \Pi_B - \Pi_A = (R_B - R_A) - (F_B - F_A) - (V_B - V_A)$$

The first term, “ $(R_B - R_A)$,” shows damages suffered because of changes in revenue that can be due to price and/or quantity changes (such as price erosion or lost sales). The second term, “ $(F_B - F_A)$,” refers to the change in fixed costs because of the event. These changes in fixed costs may include advertising and other expenses incurred due to the infringement. That is, $F_A = F_B + E$, where E is extraordinary expenses. The last term, “ $(V_B - V_A)$,” refers to change in variable costs due to the sales decline suffered due to the event.

Three methods to assess damages. Exhibit 1 compares the profits that the injured party

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expected to make with the profits that it actually made to determine the lost profits due to the trademark infringement. These models introduce the conceptual approach to damages.⁶ Damages practitioners will likely measure these losses using one of two methods: the “before/after” approach or the “yardstick” approach. The before/after approach, which economists refer to as a time series approach, considers the change in the profits before and after an event and calculates lost profits as the difference between the two. This approach presumes sufficient data is available for each period to conduct the analysis and that the event causing the interruption is time-bound.⁷ The yardstick approach is a cross-section approach in which the analyst examines the profits of similarly situated companies during the damages period. It suggests that a computation of lost profits should be based on a comparison of actual profits of target companies with a measure of expected profits that reflect economic and market experiences of similarly situated companies.

Practitioners and the courts widely accept both the before/after and yardstick methods. However, a simple use of either approach is not recommended. Events other than the one leading to the lawsuit may have contributed to the decline in profits. Failure to consider such factors opens the expert to challenge from the opposing side’s expert.

If the damaging event took place during a period of rapidly changing economic conditions for the industry, then steps should be taken to reflect these changes in the lost profits analysis. Similarly, in using a yardstick approach, the analyst should expect to be challenged on the

grounds that the target company may not be sufficiently comparable to other business(es), used as a yardstick or benchmark, in the same competitive market.

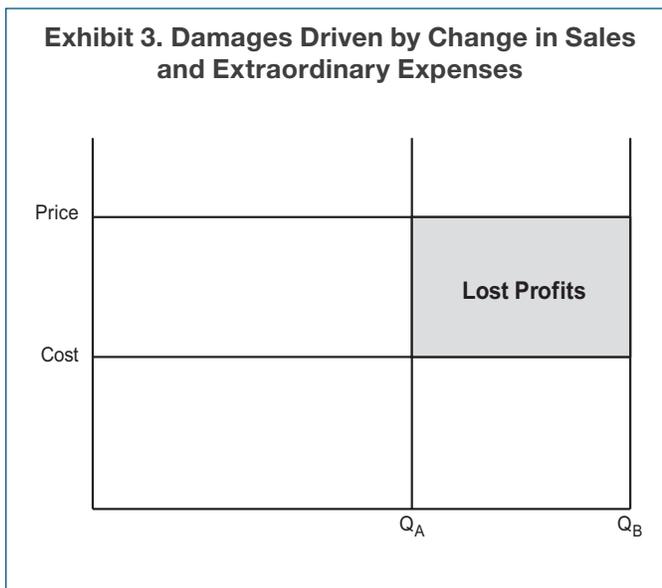
Standard approaches to estimating damages in trademark infringement cases. A plaintiff who successfully establishes a violation of Section 43(a) of the Lanham Act may obtain injunctive relief and is entitled to recover, subject to the principles of equity: (1) any damages sustained by the plaintiff; (2) the defendant’s profits; and (3) the costs of the action. The court may treble any of these damages and, in exceptional cases, may award reasonable attorney fees to the prevailing party. 15 U.S.C. §§ 1116 and 1117(a).

Plaintiff’s Lost Profits Due to Fewer Sales. While one can treat each of these and other situations as exceptions to the base lost profits model in Equation 2, we believe a more generalized model of lost profits is needed. Let us assume that in the “before” and “after” scenarios, the price did not change and fixed costs do not change, which may be reasonable assumptions for a shorter time frame. That is, $P_B = P_A = P$ and $F_B = F_A$. Expanding out the expression for but-for revenue, $R_B = P_B * Q_B$, and actual revenue, $R_A = P_A * Q_A$, in Equation 2, one obtains:

$$(3) \Pi_B - \Pi_A = [P*(Q_B - Q_A)] + E - [VC*(Q_B - Q_A)]$$

6 Nancy Fannon (2011) lists four methods: before/after, yardstick, sales projection, and market model. The approaches imply data-gathering tactics and provide different perspectives on how the expert analyzes the data.

7 The before/after approach may require a sales projection to determine “but-for” sales during a damages period. Multiple regression or other techniques may be used to make these projections, including the ability to make adjustments for seasonality and trend in these regressions.



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This expression assumes that changes in variable costs occur only because of a change in quantity. The per-unit variable costs (VC) don't change with a change in quantity, i.e., we are assuming there are no economies of scale.

In this situation, damages are driven only by the change in sales and extraordinary expenses, E, if there are any such expenses. Such a situation is likely to occur when the injured company operates in a highly competitive market and there are no economies of scale. This case is shown in Exhibit 3 (with no change in fixed expenses).⁸

Disgorgement of Defendant's Profits. Exhibit 3 can show the defendant's added profits from the trademark infringement assuming that the extra sales were due to the trademark infringement. In a situation where the defendant's profits are awarded as damages, they often assume a showing of bad faith. In some cases, disgorgement of the defendant's profits serves as a proxy for the plaintiff's lost profits due to the trademark infringement. Courts in these types of cases may use different approaches to allocate the defendant's expenses to infringing sales. If the remedy to trademark infringement is disgorgement of the defendant's profits, the plaintiff has the burden of showing lost sales, but the defendant needs to show what costs to consider in measuring unjust profits from these sales (not just deduction of incremental expenses of the defendant on ill-gotten sales).⁹ Failure to show such costs means the plaintiff may be awarded all revenue on such sales.

Costs of Corrective Advertising to Correct Public Confusion. In certain circumstances, a plaintiff may be able to recover the actual or estimated

cost of corrective advertising to remedy the false or misleading advertising.¹⁰

Where the plaintiff has already expended funds on a corrective advertising campaign, it is relatively simple for the court to evaluate the cost. For example, in *U-Haul International v. Jartran, Inc.*, the Ninth Circuit awarded the plaintiff 13.6 million dollars, which reflected the amount the plaintiff had spent in corrective advertising, even though it was over twice the cost of the original advertisement by the defendant. 793 F.2d 1034, 1037 (9th Cir. 1986).

8 This figure is derived from Strong (1995).

9 It is important to research the case law on disgorgement damages in the appropriate circuit because some courts allow for deducting costs beyond incremental costs, such as overhead costs that are directly attributable to the production of the ill-gotten sales of the defendant.

in trademark cases, but is not the only remedy. Here are a few others:

1. Expenditures to restore the *goodwill* of the plaintiff, like loss of *reputation*, may be hard to measure.
2. A *reasonable royalty* for licensing the trademark in question. The idea is that the plaintiff would have received royalty payments

from the infringer if the infringer had sought a license to the trademark rather than infringing it.

3. *Statutory damages* are stipulated payments of some fixed monetary payment per counterfeit trademark or unlawful domain name.¹¹ These rules apply to counterfeiting and require special monetary remedies. Under the 1994 Counterfeiting

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Act, treble profits and attorney fees may be awarded.

4. *Principles of equity.* According to some federal courts, Section 35 of the Lanham Act does not imply a prevailing plaintiff can obtain monetary rewards in addition to injunctive relief. Monetary relief is denied when an injunction will satisfy the *equities* of the case and there is no finding of bad faith or fraud.¹²
5. *“Compensation, not penalty.”* Section 35 of the Lanham Act grants courts considerable discretion to increase damages up to treble damages and increase or decrease awards that the court deems too low or too high, respectively.
6. *Punitive damages* are not authorized under the Lanham Act but may be obtained by the plaintiff if the venue is a state court that has statutes regarding punitive damages in trademark cases. As expected, thresholds for such an award are often willfulness and bad faith.
7. *Dilution of “famous” trademark.* The Federal Trademark Dilution Revision Act of 2006 often provides only injunctive relief.

¹² Ethan Horwitz, “Cost of Action vs. Damages in Trademark Infringement Actions in the United States,” Open Forum papers, Paper MC/3.6.

However, if willful misconduct or dilution by the infringer is established, then the United States Trademark Act permits the plaintiff to recover the defendant’s profits, damages, and attorneys’ fees and allows for the destruction of the infringing goods.

This article has mainly focused on some issues confronting measurement of actual lost profit, such as those arising from lost sales or price erosion. However, other types of damages may also be available under the Lanham Act or comparable state laws, including infringer’s profits (disgorgement) and special penalties for certain types of infringements, such as counterfeit or dilution. Even so, if actual damages are demonstrated and the plaintiff prevails, the court may increase or reduce the damages award subject to its discretion and the application of principles of equity. Damages awards in trademark cases cannot be easily described or predicted via some simple accounting or economic formula and, to some extent, are complex within the available statutes and common law.

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