

The Hobgoblin Argument: An Inconsistent Approach to Intellectual Property Damages

By Jonathan Band and Ben Grillo¹

*“A foolish consistency is the hobgoblin of little minds,
adored by little statesmen and philosophers and divines.”²*
-Ralph Waldo Emerson

I. INTRODUCTION

In the 110th Congress, the House Judiciary Subcommittee on the Courts, the Internet, and Intellectual Property, addressed the issue of damages for patent and copyright infringement in an inconsistent manner. The Patent Reform Act of 2007, H.R. 1908, sought to limit reasonable royalty damages for patent infringement by restricting the application of the entire market value rule and tightening the standard for finding an act of infringement to be willful. These changes were intended to decrease the potential size of awards. In contrast, the Prioritizing Resources and Organization for Intellectual Property Act of 2007 (“PRO-IP Act”), H.R. 4729, as introduced would have increased the awards of statutory damages available in copyright infringement cases by modifying the “one work rule” to allow multiple statutory damage awards for infringement of a compilation. This change would have permitted the exponential expansion of statutory damages.

IP Subcommittee Chairman Howard Berman stated that he did not think these two provisions were “that inconsistent.”³ However, the patent bill attempted to decrease

¹ Jonathan Band practices intellectual property law in Washington, D.C., and is an adjunct professor at the Georgetown University Law Center. He has represented clients in connection with the legislation discussed in this article, but these views expressed are his own. Ben Grillo is a second year student at the George Washington University Law School.

² Ralph Waldo Emerson, “Self-Reliance”. Published in “Essays, First Series” (1847).

³ *Prioritizing Resources and Organization for Intellectual Property Act of 2007: Hearing on H.R. 4279 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary, 110th Cong. 114 (2007) (statement of Rep. Berman, Chairman H. Subcomm. on Courts, the Internet, and Intellectual Property) (“Berman Statement”).*

patent damages by bringing them closer to the actual harm suffered by the plaintiff, while the copyright bill sought to increase copyright damages without regard to the plaintiff's injury. The patent bill was intended to diminish the patentee's incentive to litigate, while the copyright bill would have had precisely the opposite effect. For this reason, the information technology industry supported the patent bill, but opposed the copyright bill's damages provisions.

This article will examine the current state of patent and copyright damages, and how the legislation would have changed these regimes. The article will then explore the basis for the IP Subcommittee's contradictory approaches to intellectual property damages.

II. PATENT DAMAGES

A. The Status Quo

Patent damages are governed by 35 U.S.C. § 284, the relevant portion of which reads: “[u]pon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention.”⁴ In awarding damages, courts grant either a “lost profits” award or a “reasonable royalty” award for the infringement.⁵ Notably, damages for patent infringement are to be “adequate to compensate for the infringement”⁶ and therefore “by definition, make the patentee whole, as opposed to

⁴ 35 U.S.C. § 284 (2006).

⁵ Although other types of damages are theoretically possible, courts nearly always adopt one of these two approaches.

⁶ 35 U.S.C. § 284 (2006).

punishing the infringer.”⁷ In instances of willful infringement, the statute allows courts to “increase the damages up to three times the amount found or assessed.”⁸

1. Reasonable Royalty Damages

The debate on damages in H.R. 1908 centered on the calculation of a reasonable royalty. Courts have interpreted this reasonable royalty award to be the amount that the parties would have agreed to as the result of business negotiations at the time the patent was infringed.⁹ The court in *Georgia-Pacific Corp. v. United States Plywood Corp.* set out fifteen factors for courts to consider when determining the appropriate amount of a reasonable royalty award.¹⁰ These so-called “*Georgia-Pacific* factors” have become standard in jury instructions for reasonable royalty cases.¹¹ Factor thirteen allows apportionment by separating out the “portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.”¹² The royalty rate then is applied to the portion of the revenue “credited to the invention.”

2. The Entire Market Value Rule

In contrast to apportionment, the entire market value rule allows the owner of an infringed patent to recover damages based on the value of the entire product in the marketplace. Historically, the entire market value rule was applied only when the

⁷ *Riles v. Shell Exploration & Prod. Co.*, 298 F.3d 1302, 1312 (Fed. Cir. 2002).

⁸ 35 U.S.C. § 284 (2006).

⁹ See *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F.Supp. 1116, 1121 (S.D.N.Y. 1970), *modified and aff’d*, 446 F.2d 295 (2nd Cir. 1971), *cert. denied*, 404 U.S. 870 (1971) (citing *Faulkner v. Gibbs*, 199 F.2d 635, 639 (9th Cir. 1952) holding that “the primary inquiry . . . is what the parties would have agreed upon if both were reasonably trying to reach an agreement”).

¹⁰ See *Georgia-Pacific Corp.*, 318 F.Supp. at 1120 (stating that “[a] comprehensive list of evidentiary facts relevant, in general, to the determination of the amount of a reasonable royalty for a patent license may be drawn from a conspectus of the leading cases”).

¹¹ See AIPLA Model Patent Jury Instructions 12.15. Similar jury instructions are provided by the Federal Circuit Bar Association and the ABA’s Model Jury Instructions for Patent Litigation.

¹² *Georgia-Pacific Corp.*, 318 F.Supp. at 1120.

patentee could show that the entire value of the product was “properly and legally attributable” to the patented improvement.¹³ When considering component parts of the same machine, the United States Court of Claims in *Marconi Wireless Telegraph Co. v. United States* held that damages were recoverable under the entire market value rule if the patented unit “was of such paramount importance that it substantially created the value of the component parts.”¹⁴ In several cases in the early 1980s, the Federal Circuit expanded the entire market value rule to include physically separate components when those components “together constituted a functional unit” as long as the patented feature was the “basis for customer demand.”¹⁵

In its 1995 *Rite-Hite* decision, the Federal Circuit clearly articulated a two step test for applying the entire market value rule to the sale of unpatented components along with patented components: the components must function together *and* the patented component must be the basis for customer demand.¹⁶ However, when applying *Rite-Hite*’s two step test in subsequent cases, courts have relaxed the “customer demand” requirement to allow evidence of marketing or promotion to satisfy the requirement that the patented improvement is “the basis of customer demand.”¹⁷

¹³ See *Garretson v. Clark*, 111 U.S. 120, 121 (1884) (finding the entire market value rule did not apply to a patent for a method of attaching a mop head to a mop handle).

¹⁴ *Marconi Wireless Telegraph Co. v. United States*, 53 USPQ 246, 250 (Ct. Cl. 1942), *aff’d in part and vacated in part*, 320 U.S. 1 (1943).

¹⁵ *Rite-Hite Corp. v. Kelley Co., Inc.*, 56 F.3d 1538, 1549-50 (Fed. Cir.) (*en banc*), cert. denied, 116 S. Ct. 184 (1995) (summarizing development of the entire market value rule). See also *Paper Converting Machine Co. v. Magna-Graphics Corp.*, 745 F.2d 11 (Fed. Cir. 1984), *Velo-Bind, Inc. v. Minnesota Mining & Mfg. Co.*, 647 F.2d 965 (9th Cir. 1981).

¹⁶ *Rite-Hite Corp.*, 56 F.3d at 1550.

¹⁷ See *Bose Corp. v. JBL, Inc.*, 274 F.3d 1354 (Fed. Cir. 2001) (applying the entire market value rule for loudspeaker system based on infringement of enclosure design where there was a functional connection and the improvement wasn’t the basis for the demand, but contributed to it), *Micro Chemical, Inc. v. Lextron, Inc.*, 318 F.3d 1119 (Fed. Cir. 2003) (allowed award based on reasonably foreseeable future sales without requiring patented process to be basis of customer demand); *Fonar Corp. v. General Elec. Co.*, 107 F.3d 1543, 1552-53 (Fed. Cir. 1997) (upheld jury award based on entire value of MRI machine based on specific imaging feature used to market MRI machine); see also Amy L. Landers, *Let the Games Begin: Incentives*

Furthermore, in *Code-Alarm, Inc. v. Electromotive Technologies Corp.*, an unpublished Federal Circuit decision in 1997, the court found that application of the entire market value rule was “within the district court’s discretion . . . as long as there [was] a functional relationship between these components and the patented invention,” thus ignoring the “customer demand” requirement under *Rite-Hite*.¹⁸ Since then, other decisions such as *Lucent Technologies, Inc. v. Gateway* have similarly mistaken the prongs of *Rite-Hite*’s two-step test as two individual alternative grounds for applying the entire market value rule.¹⁹ The staggering jury award in *Lucent* of \$1.52 billion for the infringement of a Lucent patent on MP3 technology by Microsoft’s Windows Media Player was based, in part, on the market value of the entire computer system. Although the presiding judge overturned the judgment on other grounds, the award demonstrated the potential scope of damage awards under the entire market value rule when reduced to the functional relationship step.

3. Willful Infringement

In addition to receiving either lost profit or reasonable royalty awards, patent owners can receive up three times the amount of the damages award if the court finds that the infringement was willful. In 92% of patent cases, the patent owner pleads willfulness, and in nearly 60% of cases, willfulness is found.²⁰ Until recently, an infringer was liable for willful infringement if he had notice of another’s patent rights and

to Innovation in the New Economy of Intellectual Property Law, 46 Santa Clara Law Review 307, 355-59 (2006).

¹⁸ 114 F.3d 1206, 1997 WL 3115542, (Fed. Cir. 1997) (nonprecedential opinion).

¹⁹ (S.D. Cal. February 21, 2007). Jury Instruction No. 62 in *Lucent* instructed application of the entire market value rule if the patented features “were the basis for customer demand *or* that the patented features and the computer function together as a single unit.” (emphasis added).

²⁰ See Kimberly A. Moore, Empirical Statistics on Willful Patent Infringement, 14 Fed. Cir. B.J. 227, 232 (2004).

did not exercise “due care” to determine if his use was infringing.²¹ While the Patent Reform Act was pending in Congress, the Federal Circuit overturned this standard in *In re Seagate Technology, LLC*, stating that the previous standard was “akin to negligence” and therefore “fail[ed] to comport with the general understanding of willfulness in the civil context.”²² The Federal Circuit then articulated a new, higher standard for willfulness, holding that a patent owner must show first that “the infringer acted despite an objectively high likelihood that its actions constituted infringement,” and second show that this risk “was either known or so obvious it should have been known to the accused infringer.”²³

B. Proposed Patent Legislation – “Patent Reform Act of 2007”

Against this backdrop, in April 2007 the Patent Reform Act of 2007 was introduced simultaneously in the House and the Senate as H.R. 1908 and S. 1145.²⁴ In his statement introducing the legislation, Chairman Berman argued that “recent case law has tilted towards overcompensation which works against the primary goal of promoting innovation.”²⁵ Senator Orrin Hatch, in his introductory remarks, observed that “courts have allowed damages for infringement to be based on the market for an entire product when all that was infringed was a minor component of the product.”²⁶

H.R. 1908 proposed several changes to the law regarding reasonable royalty awards.²⁷ First, it addressed apportionment by directing a court to “conduct an analysis

²¹ *Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380 (Fed. Cir. 1983).

²² *In re Seagate Technology, LLC*, 497 F.3d 1360, 1371 (Fed. Cir. 2007).

²³ *Id.*

²⁴ Similar bills were introduced in the 109th Congress.

²⁵ Statement of Representative Howard Berman on the Patent Reform Act of 2007 (April 18, 2007).

Available online at: http://www.house.gov/list/press/ca28_berman/statement_berman_patent.doc (Accessed June 24, 2008).

²⁶ Cong. Rec. S4691 (April 18, 2007).

²⁷ Lost profits awards are not affected by the Patent Reform Act.

to ensure that a reasonable royalty... is applied only to that economic value properly attributable to the patent's specific contribution over the prior art."²⁸ Next, the Act clarified the entire market value rule, stating that "upon a showing... that the patent's specific contribution over the prior art is the *predominant basis* for market demand... damages may be based upon the entire market value of the products or processes involved."²⁹ Finally, the Patent Reform Act placed explicit limitations on willful infringement, including that "a court may not find that an infringer has willfully infringed... for any period of time during which the infringer had an informed good faith belief that the patent was invalid."³⁰

1. The Arguments in Favor of Damages Reform

The bill's specific reference to apportionment, and its limitation of the entire market value rule to the traditional customer demand test, proved enormously controversial.³¹ Supporters of H.R. 1908's damages provisions included the Coalition for Patent Fairness, representing a large number of computer and Internet companies,³² the Business Software Alliance, representing software firms,³³ and the Financial Services Roundtable, representing large financial services institutions. These entities create and use products and services with many component elements that may rely on thousands of patents. Limiting the entire market value rule and codifying apportionment, they argued, would prevent outsized damage judgments such as those awarded in *Lucent*.

²⁸ H.R. 1908 § 5(b)(2). The language in the Senate version (S. 1145) is nearly identical.

²⁹ H.R. 1908 § 5(b)(3). Emphasis added.

³⁰ H.R. 1908 § 5(c).

³¹ The amendment relating to willful infringement, particularly after the Seagate decision, was far less controversial.

³² Including Hewlett-Packard, Amazon, and Google.

³³ Including Adobe, Apple, Corel, and Microsoft.

Proponents of patent damages reform claimed that there were two primary problems in the patent system: first, there was “uncertainty concerning the extent and value of patent rights;” and second, that “innovative industry” was forced to pay “high licensing, litigation, and transaction costs” “in order to obtain clear answers.”³⁴ Professor John Thomas of Georgetown University Law Center, and Professor Viet Dinh, former Assistant U.S. Attorney General, argued that although the reasonable royalty rate was intended to approximate the market rate, “judicially awarded reasonable royalty rates often compensate well above the market rate.”³⁵ In his testimony in a House IP Subcommittee hearing, Professor Thomas identified ten cases, in addition to *Lucent*, “awarding damages that may far exceed an individual patent’s contribution to an infringing product.”³⁶

Professor Thomas and other proponents of patent reform argued that these large damage awards had several negative consequences. First, they encouraged patent litigation rather than licensing, and increased the rates of licenses in settlement of this litigation. Professor Thomas termed this a “royalty burden” on innovative companies. Secondly, the large awards resulted in an increase in “[s]o called trolls – entrepreneurial speculators who prefer to acquire and enforce patents rather than engage in research, development, manufacturing, or other socially productive activity.”³⁷ And lastly, by

³⁴ *Patent Reform Act of 2007: Hearing on H.R. 1908 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary*, 110th Cong. 65 (2007) (statement of Professor John R. Thomas, Georgetown University Law Center)(“Thomas Statement”).

³⁵ Viet Dinh and William Paxton, *Patent Reform: Protecting Property Rights and the Marketplace of Ideas*, White paper prepared for the Coalition for Patent Reform, December 3, 2007.

³⁶ Thomas Statement at 58.

³⁷ Thomas Statement at 60. *See also Ebay Inc. v. MercExchange*, 547 U.S. 388,396 (2006) (J. Kennedy, Concurring), observing that “[a]n industry has developed in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees.” *See also* Amy L. Landers, *Let the Games Begin: Incentives to Innovation in the New Economy of Intellectual Property Law*, 46 Santa Clara Law Review 307, 343-47 (2006).

failing to apportion damages properly, courts awarded damages for elements taken from prior art, the public domain, as well as technology patented by third parties, overcompensating plaintiffs unjustly.

Patent reform advocates pointed to statistical evidence that patent litigation had undergone several shifts in the last 20 years, moving away from bench trials to jury trials and away from lost profits awards to reasonable royalty awards. According to a PricewaterhouseCoopers study, through the 1990s, lost profits damages were awarded in a majority of infringement cases; while since 2000, reasonable royalties were awarded in 65% of cases.³⁸ Since lost profits are only available in cases where the patent holder could have made a sale, but failed to do so due to the infringement, this rise in reasonable royalty awards reflected an increase in ownership of patents “for the purpose of licensing (or litigation)” by entities that did not have manufacturing or distribution capabilities.³⁹

2. The Arguments Against Damages Reform.

Opponents of the Patent Reform Act included the Coalition for 21st Century Patent Reform, representing major chemical, pharmaceutical, and manufacturing companies,⁴⁰ the Innovation Alliance, representing bio-technology, venture capital, and technology research firms,⁴¹ and universities and independent inventors. To the extent some of these entities manufacture products, these products tend to include fewer patents per product than the products manufactured by the supporters of patent reform. Additionally, the Bush Administration and the Hon. Paul R. Michel, Chief Judge of

³⁸ PricewaterhouseCoopers, 2007 Patent and Trademark Damages Study (2007) at 22.

³⁹ Senate Report 110-259. (2008).

⁴⁰ Including DuPont, Dow Chemical, Exxon Mobile, AstraZeneca, Merck, 3M, and Corning.

⁴¹ Including Canopy Ventures, US Nanocorp, and Intermolecular, Inc.

the U.S. Court of Appeals for the Federal Circuit, also stated their disapproval of the damages provisions of the Patent Reform Act.

William Rooklidge, an attorney at Howrey LLP and former president of the American Intellectual Property Law Association (AIPLA), argued in a White Paper that although the Patent Reform Act claimed to codify existing law regarding apportionment and the entire market value rule, it in fact “would make substantial changes destructive to the patent system.”⁴² These changes, Rooklidge asserted, included “[f]orcing the courts to conduct an apportionment analysis in every case” which “would be a colossal waste of time” since “apportionment is only occasionally addressed by courts.”⁴³ Further, historically the burden of proof for apportionment has been on the infringer, and the proposed legislation now places it on the court.⁴⁴ Additionally, by relying on “prior art subtraction,” Rooklidge argued that the bill “vastly oversimplifies the analysis of which contributions should be apportioned.”⁴⁵ As Gary Griswold, President and Chief Counsel of Intellectual Property at 3M testified before the House IP Subcommittee, “prior art subtraction ignores the reality that at some level all inventions are combinations of old elements,” arguing that infringement of the patent on Post-It notes would result in minimal damages since both the paper and the adhesive are examples of prior art.⁴⁶ These opponents saw no reason for elevating apportionment above the fourteen other *Georgia-Pacific* factors.

⁴² William C. Rooklidge, “Reform” of Patent Damages: S. 1145 and H.R. 1908. White Paper available online at: www.patentsmatter.com/press/pdfs/Patent_Damages_Reform_Rooklidge.pdf (Accessed June 19, 2008).

⁴³ *Id.* at 4.

⁴⁴ *Id.* citing *Elizabeth v. Pavement Co.*, 97 U.S. 126, 141 (1877) (holding the burden of proof for apportionment is on the infringer).

⁴⁵ *Id.* at 5.

⁴⁶ *Patent Reform Act of 2007: Hearing on H.R. 1908 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary*, 110th Cong. 65 (2007) (statement of Gary Griswold, President and Chief Counsel of Intellectual Property, 3M)(“Griswold Statement”).

Further, opponents argued that there was “no need for such substantial changes” when “[f]urther judicial development and less-intrusive legislation could solve any problems that truly exist in the patent damages area.”⁴⁷ As Federal Circuit Judge Paul Michel stated in a speech to the Association of Corporate Patent Counsel, “[i]t’s an extremely blunt instrument to legislate; it’s not a scalpel, it’s a hammer.”⁴⁸ Opponents pointed to cases such as *In re Seagate*, where the Federal Circuit raised the standard for a finding of willful infringement, as an example of the type of judicial reform that obviated the need for legislation.⁴⁹

Further, Kevin Sharer, Chief Executive of biotechnology company Amgen argued during the House IP Subcommittee’s that “the net effect of these provisions is to make it cheaper and easier to infringe a patent,” which thereby “discourages innovation and encourages copying.”⁵⁰ This argument was echoed in a September 6, 2007 Statement of Administration Policy issued by the Office of Management and Budget stating “the Administration continues to oppose H.R. 1908’s limits on the discretion of the court in determining damages” because such a change “is unwarranted and risks reducing the rewards from innovation.”

3. *Current Status of the Patent Reform Act*

Despite these objections, the House IP Subcommittee favorably reported on the Patent Reform Act of 2007 on May 16, 2007. The bill was then adopted by the full

⁴⁷ *Id.*

⁴⁸ Hon. Paul R. Michel, Chief Judge U.S. Court of Appeals for the Federal Circuit, Address to the Association of Corporate Patent Counsel (January 28, 2008) (transcript by Federal News Service).

⁴⁹ Senate Report 110-259 (January 24, 2008), Minority View (“These decisions signify an effort by the Supreme Court and Federal Circuit to rectify perceived imbalances in the patent system. At a minimum, this recent trend by the Courts in the patent field suggests that Congress should exercise extreme caution before tilting the playing field even further towards the interests of potential infringers.”).

⁵⁰ *Patent Reform Act of 2007: Hearing on H.R. 1908 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary*, 110th Cong. 65 (2007) (statement of Kevin Sharer, CEO of Amgen).

Judiciary Committee on September 4, 2007 and passed the House of Representatives with a vote of 220 (aye) to 175 (nay) on September 7, 2007. On the Senate side, the bill encountered fierce resistance centering on the apportionment of damages and the post-grant opposition proceeding. Although the Senate Judiciary Committee favorably reported on the bill with apportionment language on January 24, 2008, it then stalled.

III. COPYRIGHT DAMAGES

A. The Status Quo

The Copyright Act allows the copyright owner “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.”⁵¹ This formulation is similar to the patent damages framework.⁵² However, the Copyright Act explicitly provides for apportionment; the defendant is permitted to prove “the elements of profit attributable to factors other than the copyrighted work.”⁵³

The Copyright Act’s damages framework differs from patent law in another significant way. The copyright owner, at any time before final judgment is rendered, may elect to recover statutory damages “instead of actual damages and profits.” For all the infringements involved in an action, with respect to any one work, the damages can range from \$750 to \$30,000, “as the court considers just.” In cases of willful infringement, the court can increase the award of statutory damages up to \$150,000; and in cases of innocent infringement, where the infringer was not aware and had no reason to

⁵¹ 17 U.S.C. 504(b).

⁵² The actual damages are parallel to the patent law’s lost profits; the actual damages represent the profit the owner would have realized on the sales he would have made but for the infringement. The infringer’s profits are parallel to patent law’s reasonable royalty; like the royalty, the infringer’s profits are based on the volume of the infringer’s sales.

⁵³ 17 U.S.C. 504(b).

believe that his acts constituted infringement, the court has the discretion to decrease the award to \$200.⁵⁴

As noted, Section 504(c)(1) allows for one award of statutory damages per work, regardless of the number of infringements of that work. Additionally, Section 504(c)(1) provides that “[f]or the purposes of this subsection, all the parts of a compilation or derivative work constitute one work.” The Copyright Act defines a compilation as “a work formed by the collection and assembling of preexisting materials or data....” The Act defines a derivative work as “a work based on one or more preexisting works ... in which a work may be recast, transformed, or adapted.” Under the last sentence of Section 504(c)(1) – the so-called “one work rule” – only one award of statutory damages could be made for the infringement of an anthology of ten short stories or a computer program that had five major releases.

Since its inclusion in the 1976 Copyright Act, the one work rule has not been the subject of judicial controversy. Courts consistently have ruled that a record label could receive only one award of statutory damages for the infringement of a compact disc that contained numerous tracks assembled by the label.⁵⁵ At the same time, courts have made clear that the one work rule applied to compilations assembled by the plaintiff, not the defendant.⁵⁶ In other words, the infringer could not reduce his exposure to statutory

⁵⁴ When the infringer is a non-profit library, archive, educational institution, or public broadcaster, the court has the discretion in certain instances to remit statutory damages altogether.

⁵⁵ See *UMG Recordings, Inc. v. MP3.com, Inc.*, 109 F. Supp. 2d 223 (S.D.N.Y. 2000), *Arista Records v. Launch Media*, 2006 WL 2591086 (S.D.N.Y. 2006).

⁵⁶ See *Twin Peaks Productions, Inc. v. Publications Int'l., Ltd.*, 996 F.2d 1366 (2d Cir. 1993) (refusing to apply the one work rule where defendant compiled separate episodes of television show ‘Twin Peaks’ on videotape); *WB Music Corp. v. RTV Communication Group, Inc.*, 445 F.3d 538 (2d Cir. 2006) (refusing to apply one work rule where defendant created CD based on songs distributed separately by the plaintiff).

damages by bundling multiple works. Nonetheless, bills in previous Congresses have proposed the repeal of the one work rule.⁵⁷

B. Proposed Copyright Legislation – “PRO-IP Act”

The PRO-IP Act of 2007, as introduced, included at section 104 a provision that replaced the one work rule with language entitling a copyright owner to “recover statutory damages for each copyrighted work sued upon that is found to be infringed” and allowing a court to “make either one or multiple awards of statutory damages with respect to infringement of a compilation . . . or a derivative work and any preexisting works upon which it is based.”⁵⁸ The amendment stated that “[i]n making a decision on the awarding of such damages, the court may consider any facts it finds relevant relating to the infringed works and the infringing conduct, including whether the infringed works are distinct works having independent economic value.”

This change would significantly increase the potential award a copyright holder could receive. For example, a defendant who is found liable for infringement of ten tracks from the same CD, under the current one work rule, is only liable for one award of statutory damages, ranging from a minimum of \$200 (for innocent infringement), to a maximum of \$150,000 (for willful infringement). However, under proposed Section 104, a court could make a separate award for each track, expanding the amount of statutory damages to \$1.5 million. Further, each track could actually contain three copyrights – one for musical composition, one for the lyrics, and one for the sound recording – driving

⁵⁷ See H.R. 6052, “Copyright Modernization Act of 2006” (109th Congress); H.R. 2391, “Cooperative Research and Technology Enhancement (CREATE) Act of 2004, (108th Congress); S.1933 “Enhancing Federal Obscenity Reporting and Copyright Enforcement (ENFORCE) Act of 2003” (108th Congress).

⁵⁸ H.R. 4729 §104, 110th Cong. (2007).

the potential statutory damages up to \$4.5 million. Because of its sweeping effect, Section 104 quickly became the most controversial provision of the broader PRO-IP Act.

1. The Arguments in Favor of Repeal of the One Work Rule

In contrast to the very public debate concerning apportionment of patent damages, which was discussed in several hearings in the House and the Senate over two Congresses, and was the subject of numerous written submissions, the proposed repeal of the one work rule had a much lower profile. Indeed, although it was widely assumed that the record labels and the music publishers stood behind the repeal, there are no publicly available written documents to that effect. Moreover, the sponsors of the PRO-IP Act never provided a detailed articulation of the rationale for the proposed repeal. At a hearing on the PRO-IP Act on December 13, 2007, Judiciary Committee Chairman John Conyers (D-MI) briefly stated with respect to the one work rule that “the current law is outdated. Damages need to reflect that fact that we live in a world where music and published works are being consumed in bite-sized pieces, not just in albums or whole books.”⁵⁹ Similarly, IP Subcommittee Chairman Howard Berman argued that although he understood why the one work rule was enacted at “a very different time when technology was very different,” he questioned the current “policy reason to distinguish between infringer ‘A’ who takes 20 photos from one site, and infringer ‘B’ who takes 20 photos, one each from 20 Web sites.”⁶⁰ Importantly to Chairman Berman, “104 authority [modifying the one-work rule] is a discretionary authority. It is not a mandate.”⁶¹

⁵⁹ *Prioritizing Resources and Organization for Intellectual Property Act of 2007: Hearing on H.R. 4279 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary*, 110th Cong. 21 (2007) (statement of John Conyers, Chairman H. Comm. on the Judiciary).

⁶⁰ Berman Statement at 115.

⁶¹ Berman Statement at 34.

At the hearing, in a case of dueling analogies, Mr. Rick Cotton of NBC-Universal argued that the judicial discretion permitted in the proposed amendment was similar to the distinction a court would make between petty larceny and grand larceny where the “criminal assessment is exactly the extent of the damage and the extent of the criminal act.”⁶² Accordingly, Mr. Cotton asserted, the court should be able to look at the “number of infringements involved, and therefore the extent of the damage to what... may be multiple different owners and creators.”⁶³ This metaphor was countered by Congressman Adam Schiff (D-CA), who instead analogized application of the one work rule to the theft of a car, saying that “when we charge someone with theft of an automobile” we don’t “charge them with theft of an automobile, theft of the radio in the automobile, theft of the seats in the automobile, or the theft of a briefcase in the automobile, even though the briefcase might belong to someone different than the automobile belonged to.”⁶⁴

2. The Arguments Against Repeal of the One Work Rule.

The opponents of the amendment, which included technology companies, library associations, and public broadcasters, explained the basis of their opposition in detail at a meeting on Section 104 hosted by the Copyright Office on January 25, 2008,⁶⁵ and in a

⁶² *Prioritizing Resources and Organization for Intellectual Property Act of 2007: Hearing on H.R. 4279 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary, 110th Cong. 117 (2007)* (statement of Rick Cotton, Executive Vice President and General Counsel, NBC-Universal). Mr. Cotton’s prepared testimony on behalf of the Coalition Against Counterfeiting and Piracy, while supportive of the PRO-IP Act in general, did not specifically address the repeal of the one-work rule.

⁶³ *Id.*

⁶⁴ *Prioritizing Resources and Organization for Intellectual Property Act of 2007: Hearing on H.R. 4279 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary, 110th Cong. 124 (2007).*

⁶⁵ The Copyright Office convened the meeting at the request of the House Judiciary Committee. The agenda items included: 1) *Legislative Intent*: What is the purpose of the last sentence of 17 U.S.C. § 504(c)(1)?; 2) *Interpretation*: What does the provision mean? Is the meaning clear?; 3) *Practical experience*: What has been our actual experience with the operation of this provision?; 4) *Evaluation*: Are the purposes we have identified as underlying § 504(c)(1) still being served by the provision today?; 5) *Legislation*: Should § 504(c)(1) be amended? And if so, is section 104 of H.R. 4279 the right approach?

written submission to the Office after the roundtable.⁶⁶ Much of the meeting, and the subsequent submission, were devoted to a discussion of the legislative history of the one work rule. Opponents of the repeal (and proponents of the rule) argued that the one work rule was a compromise between competing views of how statutory damages should work under the 1976 Act.⁶⁷ Section 504(c)(1) as enacted balanced the Copyright Office's initial proposal of one award for all infringements of all works with some owners' preference for one award for each work infringed. By allowing one award for each work, but then defining compilations and derivative works as a single work, the provision discouraged infringements of multiple works while ensuring that statutory damages would not be "pyramided to an exorbitant total."⁶⁸ The statutory damages provision, including the one work rule, was consciously designed to provide: courts with broad discretion of a range of damages (then from \$100 to \$50,000); defendants with a degree of certainty concerning the limit of their exposure; and copyright owners with the option of pursuing actual damages if statutory damages did not adequately compensate them for their injury.

In response to the argument that the one work rule was outdated and should not apply to the digital world where compilations such as websites could include many works, Section 104 opponents identified references in the legislative history to compilations with a large number of included works. The opponents also argued that many online delivery systems such as iTunes would not meet the definition of

⁶⁶ Library Copyright Alliance et. al., *The Threat Posed By Inflated Statutory Damages: Comments on the January 25, 2008 Meeting Hosted by the Copyright Office*, submitted to the Library of Congress, Copyright Office. (2008). Available online at: www.arl.org/bm~doc/jointparties-sec104cmts.pdf.

⁶⁷ See William Patry, *What Does it Mean to Be Pro-IP?*, <http://williampatry.blogspot.com/2007/12/what-does-it-mean-to-be-pro-ip.html> (2007).

⁶⁸ Copyright Law Revision: Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law 107 (House Comm. Print 1961).

compilation in 17 U.S.C. § 101, and accordingly would not be subject to the one work rule.⁶⁹ The opponents further argued that in enacting the Digital Millennium Copyright Act (DMCA), Congress anticipated the possibility that \$150,000 might not adequately compensate operators of websites hosting a large number of copyrighted works.⁷⁰

Additionally, opponents of Section 104 argued that the proponents had produced no evidence that current levels of statutory damages were insufficient to combat infringement or that content creators had been chilled in issuing compilations as a result of the “one work” rule.⁷¹ While one could imagine hypothetical situations where the one work rule might lead to anomalous results, such situations had not occurred in practice; and if statutory damages in a certain case proved insufficient to compensate a copyright owner, the rightsholder could still recover actual damages. Further, opponents asserted that increased statutory damages only strengthened plaintiffs’ leverage in lawsuits, leading to problems ranging from the emergence of copyright trolls seeking and obtaining “nuisance settlements,” to creators self-redacting works to avoid litigation, to an

⁶⁹ Under section 101, a compilation “is a work formed by the collection and assembling of preexisting materials...” While a list of tracks available on iTunes likely is a compilation, the tracks themselves stored on Apple’s servers are not “assembled” into a “work.” They are individual files stored on servers around the world. These tracks are no more a compilation than all books in a bookstore or the albums in a record store.

⁷⁰ In the DMCA, Congress prohibited the circumvention of technological measures employed by copyright owners to protect economically valuable content on the Internet. Under 17 U.S.C. § 1203(c)(3)(A), each act the circumvention is subject to up to \$2,500 in statutory damages. With existing inexpensive digital rights management technologies, a copyright owner can protect each work individually. Thus, infringement of 1000 photographs on a website may result in 1000 discrete acts of circumvention, each subject to \$2,500 of statutory damages. Moreover, if the copyright owner places a watermark on each photograph, the removal of the watermark may subject the infringer to another \$25,000 per photograph. Section 1203(c)(3)(B) of the DMCA allows the copyright owner to recover statutory damages of \$25,000 for each act of removal or alteration of “copyright management information”, which would include a section 1202(c)-conforming watermark. Hence, the DMCA provides up to \$27,500 in statutory damages for each individual work, regardless of the one work rule. This \$27,500 is in addition to the actual or statutory damages that the copyright owner could recover under section 504.

⁷¹ In fact, they point out that compilations, particularly for TV shows on DVD, have only increased since the 1976 Copyright act.

exacerbation of the orphan works problem. Finally, the opponents claimed that the elimination of the one work rule would chill innovation by significantly increasing technology companies' exposure to damages in cases involving secondary liability.

3. Current Status of Section 104 of the PRO-IP Act

Because of the strong opposition to Section 104, and the absence of visible support, the provision was not included in the "Chairman's Mark" of H.R. 4279 approved by the IP Subcommittee on March 6, 2008 and the full Committee on May 5, 2008. The final version of the bill, still without section 104, passed the House by a 410-11 margin on May 8, 2008. IP enforcement legislation in the Senate does not contain language similar to the proposed repeal of the one work rule in Section 104.

IV. ANALYSIS

Before the December 13, 2007 hearing on the PRO-IP ACT, numerous entities pointed out the inconsistency between Section 104 and the apportionment of damages in the Patent Reform Act. A letter from technology companies and associations including Google, Yahoo, and eBay, stated: "section 104 will encourage copyright trolls to manufacture or take advantage of infringements for the purpose of extorting large settlements. Section 104 would create the same incentives for frivolous copyright litigation that this Committee sought to prevent in the patent context with the Patent Reform Act of 2007, H.R. 1908."⁷² Similarly, the written testimony of the non-profit group Public Knowledge stated:

⁷² Letter from Ask.com, CNET Networks, eBay Inc, Google, PayPal, Real Networks, Visa Inc., Yahoo!, Computer and Communications Industry Association, Digital Media Association, and Net Coalition to Rep. Howard Berman, Chair, House Subcomm. on Courts, the Internet, and Intellectual Property and Rep. Howard Coble, Ranking Member, House Subcomm. on Courts, the Internet, and Intellectual Property (December 12, 2007) (on file with author).

H.R. 1908, passed by the House this September, calls on the courts to apportion patent damages relative to the actual harm done. In the patent context, the House has recognized that multiplied damages can threaten innovation by encouraging more frivolous claims and distorted settlements. [Section 104] takes a step backwards in the copyright realm even as patent law takes a step toward sanity.⁷³

During the December 13 hearing, when questioning Gigi Sohn of Public Knowledge, Chairman Berman referenced her written testimony “that my approach on damages in copyright is somehow inconsistent with my approach to damages in the patent bill. Other than the hobgoblin argument, I actually don’t think they are that inconsistent.”⁷⁴ He then tried to turn the tables on her, stating that in the patent context, Sohn “never argued that we should, on a counterfeit product that infringed 50 different patents because it was all one product, consider it as one patent violation. Our goal in the patent bill was simply to give the court discretion that courts here have to decide on how to calculate the damages.”⁷⁵

But Chairman Berman’s goal in the patent bill was to reduce courts’ discretion, not increase it. The patent bill attempted to limit the circumstances in which courts could apply the entire market value rule. Moreover, even under the entire market value rule, if a product infringed 50 different patents, the damages would be limited to a royalty on the entire product; the infringer would not be liable for 50 royalties on the entire product. This is because patent damages – whether lost profits or reasonable royalty – attempt to compensate the patentee for the actual harm he has suffered. Even the trebling of

⁷³ *Prioritizing Resources and Organization for Intellectual Property Act of 2007: Hearing on H.R. 4279 Before the H. Subcomm. on Courts, the Internet, and Intellectual Property of the H. Comm. on Judiciary*, 110th Cong. 65 (2007) (statement of Gigi Sohn, Director, Public Knowledge).

⁷⁴ *Id.* at 114.

⁷⁵ Berman Statement at 115.

damages for willful infringement, which is intended to punish and deter, is correlated to the actual injury, i.e., three times the actual damage.

In contrast, statutory damages in copyright have no relationship to the copyright owners' actual injury. They are an alternative form of relief available to the copyright owner at levels set by Congress. To be sure, the Copyright Act also makes actual damages available to copyright owners. If a compilation infringes 50 different copyrights, the copyright owners certainly are entitled to seek a separate award of actual damages for each work infringed. Thus, Chairman Berman was comparing apples with oranges. The availability of actual damages under patent law (or copyright law) for each patent (or copyright) infringed says nothing about how statutory damages for copyright infringement should be assessed.

Although actual and statutory damages are different creatures that largely satisfy different policy objectives (compensation versus punishment and deterrence), they both must maintain a degree of proportionality to avoid socially undesirable results such as incentivizing litigation and the extraction of excessive licensing fees by “trolls.” In the patent context, the House IP Subcommittee determined that inappropriate application of the entire market value rule led to disproportionately large awards. Accordingly, the Subcommittee attempted to define more clearly when courts should apportion and when they should employ the entire market value rule. The very same Subcommittee, however, considered making copyright damages even more disproportionate by repealing the one work rule. Fortunately, the Subcommittee members ultimately recognized that proportionality is not foolish consistency, and wisely dropped Section 104 from the PRO-IP Act.