Golden Gate University Law Review

Volume 16
Issue 1 *Ninth Circuit Survey*

Article 8

January 1986

Copyright Law

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COPYRIGHT LAW

SUMMARY

INDIRECT PROFITS MAY BE INCLUDED AS DAMAGES FOR COPYRIGHT INFRINGEMENT

I. INTRODUCTION

In *Frank Music v. Metro-Goldwyn-Mayer*,[1] the Ninth Circuit found that indirect profits from an infringing use of a copyright could be included in a computation of the infringer's profits under section 101(b) of the Copyright Act of 1909.[2]

Plaintiffs filed suit alleging copyright infringement, unfair competition and breach of contract, after defendants used five songs from plaintiffs' dramatico-musical play, *Kismet*, in a musical revue staged at the MGM Grand Hotel in Las Vegas between 1974 and 1976. Defendants, the hotel-casino operator and the show's producer-director, claimed their use fell within the terms of a blanket license agreement between themselves and the American Society for Composers, Authors and Publishers (ASCAP).[3] The district court[4] found that the license specifically excluded use of "visual representations"[5] of plaintiffs' work, that

1. 772 F.2d 505 (9th Cir. 1985) (per Fletcher, J.; other panel members were Boochever, J., and Reinhardt, J.).

2. 17 U.S.C. § 101(b) (1970). Although this Act has been superceded by the Copyright Act of 1976, current Title 17 of the United States Code, all actions complained of in this suit occurred before the effective date of the new Act, January 1, 1978. 772 F.2d at 512 n.4.

3. 772 F.2d at 510. In 1965, plaintiffs granted to ASCAP the right to license certain rights in the musical score of their play. *Id.*

4. Trial was held in the United States District Court for the Central District of California, Robert J. Kelleher, District Judge, presiding.

5. 772 F.2d at 511. Paragraph 3 of the license provided, in pertinent part, that "[t]his license shall not extend to or be deemed to include: . . . songs or other excerpts

the defendants' use was therefore an infringing use, and awarded plaintiffs $22,000 as that share of defendants' profits attributable to the infringement.[6] The district court dismissed the unfair competition and breach of contract claims. Both parties appealed.

II. COURT'S ANALYSIS

The Ninth Circuit affirmed the district court's finding that the defendants' use was beyond the scope of their license.[7] On appeal, the defendants argued that the district court failed to give sufficient consideration to the source of alleged copying. Defendants claimed that visual representations which could be said to have been derived from the original stage play, *Kismet*, would not be protected by plaintiffs' copyright which extended only to the dramatico-musical adaptation of the play.[8] The panel found this argument unpersuasive on two counts: 1) that the evidence established that the producer had access to and relied on the plaintiffs' Broadway score; and 2) that the question of the copyrightability of the "visual representations" was irrelevant, since the prohibition in the license was not limited to "copyrightable" visual representations.[9]

The panel then turned to the issue of damages. The Copyright Act of 1909[10] provided for recovery of "such damages as the copyright proprietor may have suffered due to the infringement, as well as all the profits which the infringer shall have made from such an infringement."[11] Actual damages are the extent to which the market value of a copyrighted work has been injured or destroyed by an infringement.[12] A court could also

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from operas or musical plays accompanied either by words, pantomime, dance, or *visual representation* of the work from which the music is taken . . . ." *Id.* at 511 n.2 (emphasis added).

6. *Id.* at 509.

7. *Id.* at 512.

8. *Id.* at 511. The original dramatic play *Kismet* was written by Edward Knoblock in 1911 and copyrighted as an unpublished work that same year. The work was again copyrighted as a published work in 1912. These copyrights expired in 1967 and thus the work was in the public domain at the time of the defendants' infringement. *Id.* at 509-10.

9. *Id.* at 512. *See supra* note 5.

10. 17 U.S.C. § 101(b) (1970).

11. *Id.*

12. 772 F.2d at 512 (quoting 3 M. NIMMER, NIMMER ON COPYRIGHT § 14.02 at 14-6 (1985)).

award statutory "in lieu" damages.[13] The Ninth Circuit had always interpreted the above-quoted section of the Act as allowing the greater of the actual damage to plaintiff's copyright or the infringer's profits.[14]

The district court in the instant case found that the plaintiffs had failed to prove any actual damage to their copyright, since they had failed to show that the market value of the copyrighted work had been diminished.[15] The test in the Ninth Circuit for determining market value at the time of the infringement is "what a willing buyer would have been reasonably required to pay to a willing seller for plaintiffs' work."[16] Plaintiffs introduced opinion testimony to the effect that defendants' use had completely destroyed the market in Las Vegas for a full production of *Kismet*, thereby entitling them to recover the value of a license for a full production.[17] Although this testimony was uncontradicted, the Ninth Circuit noted that the trial court was entitled to reject any proffered measure of damages which is too speculative.[18] Uncertainty as to the *amount* of actual damages will not prevent their recovery, but uncertainty as to the fact of damages may.[19] Plaintiffs had not presented any "disinterested testimony" to the effect that defendants' use of six minutes of plaintiffs' work precluded plaintiffs from presenting *Kismet* in its entirety at another hotel.[20] Since it was reasonable to conclude that defendants' use did not significantly impair the prospects of presenting a full production, the panel concluded that the district court was not clearly erroneous in finding plaintiffs' theory of damages too uncertain and speculative.[21]

Because the court determined that no actual damage had

13. 17 U.S.C. § 101(b) (1970). This section allowed the court to award, "in lieu of actual damages and profits, such damages as the copyright proprietor may have suffered due to the to the court shall appear to be just." *Id. See infra* note 45.

14. 772 F.2d at 512 & n.5.

15. *Id.* at 513.

16. *Id.* at 513 n.6 (citing Sid & Marty Krofft Television Productions v. McDonald's, 562 F.2d 1157, 1174 (9th Cir. 1977) (*Krofft I*)).

17. 772 F.2d at 513.

18. *Id.*

19. *Id.* (citing Universal Pictures v. Harold Lloyd Corp., 162 F.2d 354, 369 (9th Cir. 1947))(emphasis added).

20. 772 F.2d at 513. The opinion testimony relating to the value of a license for a full production was given by the copyright owner and the leasing agent. *Id.*

21. *Id.* at 513-14.

occurred, it turned to the issue of the infringer's profits. In establishing the infringer's profits, the plaintiff is required to prove only the defendant's gross revenue from the infringement; the burden then shifts to the defendant to prove the elements of costs to be deducted from revenue to arrive at profit.[22] However, in the event the infringement is willful, conscious or deliberate, there is no deduction for the infringer's overhead.[23]

The district court allowed deductions for direct and indirect costs amounting to eighty-nine percent of the revenue collected for defendants' revue.[24] The plaintiffs appealed these calculations on several grounds.[25] Plaintiffs first argued that the defendants' use was willful and deliberate and, therefore, no deductions should have been allowed. The Ninth Circuit rejected this argument, affirming the district court's determination that defendants believed they were acting within the scope of their ASCAP license.[26]

Plaintiffs further charged that the defendants had failed to adequately prove that each item of claimed overhead assisted in the production of the infringing revue. Defendants calculated the claimed expenses by allocating a portion of the total operating expenses of the hotel based on the ratio between the revenue generated by the show and the total revenue of the hotel.[27] The district court accepted nearly all of the defendants' calculations as presented.[28] While the Ninth Circuit accepted the district court's finding that this method of allocation was a reasonably acceptable formula, the panel concluded that defendants had failed to prove that these expenses actually contributed to the production of the show.[29] The court stated:

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22. *Id.* at 514 (citing 17 U.S.C. § 101(b) (1970)).

23. *Id.* at 515 (citing Kamar Int'l v. Russ Berrie & Co., 752 F.2d 1326, 1331 (9th Cir. 1984)).

24. *Id.* at 514-15. The district court found gross revenue from the revue of $24,191,690 from which it deducted $18,060,084 of direct costs and $3,641,960 of indirect costs (overhead) to arrive at a net profit of $2,489,646. *Id.* at 515.

25. *Id.* at 515. Plaintiffs made several challenges, although the court dealt with some of them in a footnote. *Id.* at 515 n.9. These challenges pertained to the district court's failure to exclude, as a sanction for failure to cooperate in discovery, certain evidence offered by the defendants. All of these challenges were rejected by the court. *Id.*

26. *Id.* at 515.

27. *Id.* at 516.

28. *Id.* at 516 & n.10.

29. *Id.* at 516.

> [A] deduction for overhead should be allowed "only when the infringer can demonstrate that [the overhead expense] was of actual assistance in the production, distribution or sale of the infringing product." [citations omitted]. We do not take this to mean that an infringer must prove his overhead expenses and their relationship to the infringing production in minute detail. [citations omitted]. Nonetheless, the defendant bears the burden of explaining, at least in general terms, how claimed overhead actually contributed to the production of the infringing work.[30]

The Ninth Circuit noted that the defendants had offered no evidence of what costs were included in the general categories presented to the trial court, nor did they offer any evidence concerning how these costs contributed to the production of the infringing show.[31] The panel concluded, therefore, that the district court's finding that defendants had established the connection between the claimed expenses and the production was clearly erroneous.[32]

The question of whether plaintiffs were entitled to recover "indirect profits" from an infringment was one of first impression before the court. Plaintiffs specifically challenged the failure of the district court to include MGM's profits from its hotel and casino operations in arriving at the gross revenue. In its computations, the district court had relied only upon the gross revenue from the show, apparently ignoring the plaintiffs' claim.[33] The court first looked to the 1909 Act, which provided that the copyright owner was entitled to "all the profits which the infringer shall have made . . . ."[34] The panel concluded that the language was broad enough to permit recovery of indirect as well as direct profits.[35] The court also looked to other cases from the Ninth Circuit, including *Sid & Marty Krofft Television Pro-*

30. *Id.* (quoting Kamar Int'l v. Russ Berrie & Co., 752 F.2d 1326, 1332 (9th Cir. 1984)).

31. 772 F.2d at 516.

32. *Id.*

33. *Id.* at 516-17.

34. *Id.* at 517 (refering to 17 U.S.C. § 101(b) (1970)).

35. *Id.*

ductions v. McDonald's (Krofft II),[36] where the court awarded substantial statutory "in lieu" damages for use of plaintiff's characters in a series of television commercials.[37] Although the court in *Krofft II* found plaintiff's formula for computing the indirect profit to be too speculative, the court found a higher award of damages to be warranted where a significant portion of the infringer's profit was not "ascertainable."[38]

The panel here found the promotional value of defendants' show to be analogous to the promotional value of the television commercials in *Krofft II*. Since the purpose of the show was to draw people to the hotel and gaming tables, the court concluded that the profits from these operations should be included in the damage computation, if such amounts could be ascertained.[39]

The court then addressed the issue of apportioning profits between those attributable to the infringing acts and those attributable to other factors. The burden of proving the contribution of profit elements other than the infringed property is the defendant's.[40] Only a just and reasonable apportionment is required; the trial court need not be exact and a formula will be upheld so long as it is not clearly erroneous.[41] The district court determined that the plaintiffs should be awarded $22,000, but gave no reasoned explanation or formula for its apportionment.[42]

The Ninth Circuit determined that the district court's award was grossly inadequate.[43] The panel examined the record and found conflicting evidence as to the relative importance of

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36. 1983 COPYRIGHT LAW DECISIONS (CCH) ¶25,572 at 18,381 (C.D. Cal. 1983)(*Krofft II*), *on remand from* 562 F.2d 1157 (9th Cir. 1977).

37. *Id.* at 18,387.

38. *Id.* at 18,384 & n.11. The plaintiffs in the *Krofft* cases, creators of the "H.R. Pufnstuf" children's television program, alleged that they were entitled to a portion of the profit earned by McDonald's on its food sales as damages for the "McDonaldland" television commercials which infringed on plaintiffs' copyright. The Ninth Circuit rejected plaintiffs' formula for computing these profits as speculative. However, in awarding $1,044,000 in statutory "in lieu" damages, the Ninth Circuit stated that "because a significant portion of the defendant's profits are unascertainable, a higher award of in lieu damages is warranted." *Id.*

39. 772 F.2d at 517.

40. *Id.* at 518 (citing Lottie Joplin Thomas Trust v. Crown Publishers, 592 F.2d 651, 657 (2nd Cir. 1978)).

41. 772 F.2d at 518.

42. *Id.*

43. *Id.*

the *Kismet* music to the defendants' show. The panel also noted that the award amounted to less than one percent of MGM Grand's profits from the show, which was wholly disproportionate both to the success of the show and to the magnitude of the defendants' profit.[44] The panel remanded the apportionment issue to the district court with instructions to fully explain its reasons and the resulting method of apportionment it selects, and to include indirect profits in the calculation if possible. The panel cautioned, however, that if the district court was unable to devise a reasonable, nonspeculative formula, then the district court should grant statutory "in lieu" damages.[45]

In its discussion of statutory damages, the Ninth Circuit reiterated the purposes of the remedy provisions of the Copyright Act: to provide adequate compensation to the copyright owner, to discourage wrongful conduct, and to deter infringement.[46] The panel concluded that the district court's award was obviously too little to discourage wrongful conduct or deter infringment, and instructed the district court on remand to exercise its discretion to award statutory damages which effectuate the purposes of the Act.[47]

The Ninth Circuit also reversed the district court's apparent judgment of joint and several liability of the defendants.[48] The panel noted that joint and several liability is proper for an award of actual damages, but that each infringer is liable for its

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44. *Id.* The court noted in a footnote that the apportionment percentages in similar cases were markedly higher. *Id.* at 518 n.11 (citing, inter alia, Universal Pictures v. Harold Lloyd Corp., 162 F.2d 354, 377 (9th Cir. 1947)(infringing use of one comedy sketch in motion picture; court affirmed award of 20% of infringing movie's profits)).

45. *Id.* at 519. Statutory "in lieu" damages are mandatory when injury to copyright has been proved, but neither the actual damages to the copyright owner nor the infringer's profit can be ascertained. Under the 1909 Act, if either actual damages or infringer's profits are ascertainable, then the trial court has discretion to award statutory damages. 17 U.S.C. § 101(b) (1970). Under the current Act, statutory damages are available at plaintiff's election *instead of*, not in addition to, actual damages and profits. 17 U.S.C. § 504(c) (1976). Such an award must be in excess of the amount which would have been awarded as profits or actual damages. *Frank Music*, 772 F.2d at 520. Under the current Act, statutory damages are limited to a maximum of $10,000 per work infringed, unless plaintiff shows the infringement was willful, in which case the maximum is $50,000 per work infringed. 17 U.S.C. § 504(c) (1976).

46. 772 F.2d at 520.

47. *Id.*

48. *Id.* at 519. The district court's judgment was rendered "against defendants." The Ninth Circuit interpreted this to mean joint and several liability. *Id.*

share of infringing profits; one defendant is not liable for the profits of another.[49] The panel remanded the question of joint liability to the district court, with instructions to consider defendant producer-director's relation to the production (employee, independent contractor or partner), whether he received a salary or a percentage of profits from defendant MGM Grand, or whether he bore any risk of loss on the production.[50] The panel went on to state that the hotel's parent company, MGM, Inc., might also be liable for its subsidiary, and the parent company's profits included in a damage calculation, if the district court should find a "substantial and continuing connection" between MGM Grand and MGM, Inc.[51]

The panel concluded by affirming the district court's dismissal of plaintiffs' unfair competition and breach of contract claims.[52]

III. CONCURRENCE

Judge Reinhardt filed a one paragraph concurrence. While he agreed almost completely with the majority, he disagreed with the district court's finding that the plaintiffs had failed to prove actual damage to their copyright. He concluded that the market value of the plaintiffs' copyright was reduced by the inclusion of *Kismet* music in over 1700 performances of defendants' show.[53]

IV. CONCLUSION

Although the Ninth Circuit's decision is framed in terms of the 1909 Act, it is clear that its rulings regarding the inclusion of indirect profits are equally applicable to the provisions of the current Copyright Act.[54] The current Act contains similar language regarding recovery of an infringer's profits.[55] This decision

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49. *Id.*

50. *Id.*

51. *Id.* at 519-20. The plaintiffs' would be limited to a single recovery, however, to be satisfied by either the parent or the subsidiary. *Id.* at 520.

52. *Id.* at 520-21.

53. 772 F.2d at 521 (Reinhardt, J., concurring).

54. 17 U.S.C. § 504 (1976).

55. The current statute provides, in pertinent part, for the recovery of "actual dam-

could also significantly increase recovery for copyright infringement in the Ninth Circuit, as the new Act unequivocally provides that actual damages *and* infringer's profits are recoverable.[56] It will be interesting to note how other circuits deal with the indirect profits issue when confronted by it. The Ninth Circuit may well turn out to be a pioneer of larger awards for copyright infringement.

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age suffered by . . . [the copyright owner(s)] 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." 17 U.S.C. § 504(b) (1976) (emphasis added). The 1909 Act allowed recovery of "all the profits which the infringer shall have made from such infringement . . . ." 17 U.S.C. § 101(b) (1970). *See supra* text accompanying notes 33-35.

56. 17 U.S.C. § 504(b) (1976). For a discussion of this case as it impacts on copyright law practice, see 2 COPYRIGHT L.J. 38 (1985).

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