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## Copyright Infringement's Blurred Lines: Allocating Overhead in the Disgorgement of Profits

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*In Williams v. Bridgeport Music, Marvin Gaye's estate alleged that the popular song "Blurred Lines" infringed Gaye's 1977 song "Got to Give It Up." As part of the remedy for the infringement, the Gaye estate sought to disgorge the profits derived from defendants' infringement, but the parties disagreed about how to calculate those profits. Specifically, they disagreed about whether the infringing song's revenues should be offset by the infringers' \$7 million in overhead costs allocable to the song. The district court determined that the infringers' ability to offset overhead costs would depend on whether their infringement was willful; it held that inadvertent infringers are entitled to offset overhead, while willful infringers are not. A few months later, however, in Oracle America, Inc. v. Google, Inc., a different district judge in the Ninth Circuit explicitly disagreed with the Williams court in reaching a different conclusion.*

*As these examples illustrate, this issue—whether to reduce disgorgement awards to account for overhead costs in copyright infringement cases—has vexed courts. Some courts, such as the Second Circuit, have held that infringement-related overhead should always be factored in to reduce disgorged profits. Other courts, such as the Seventh Circuit, have held that overhead should never be factored in. Still others have held that it should be factored in only if the defendant's infringement was willful.*

*In this Article, I argue that all of these holdings are wrong. Specifically, I argue that overhead should reduce the defendant's profit calculation only when the defendant can prove that, but for the infringement, it would have utilized the assets represented by the overhead in some other revenue-generating fashion. Although there may be a rough correlation between this analysis and an analysis of the defendant's*

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*willfulness, the focus on willfulness emphasizes the wrong consideration, resulting in much of the confusion that permeates the current law.*

*Part of this confusion stems from a disagreement regarding the purpose of the disgorgement remedy. Some argue that disgorgement is coercive, others that it is punitive, and still others that it is compelled by notions of corrective justice. I contend in this Article that corrective justice best accounts for the features of copyright disgorgement. I also argue that only by considering the defendant's conduct through a non-infringing counterfactual can we achieve disgorgement's goal, as described in *Sheldon v. Metro-Goldwyn Pictures Corp.*, of a "rational separation of net profits so that neither party may have what rightfully belongs to the other."*

## CONTENTS

I. INTRODUCTION.....	1061
II. VARIOUS APPROACHES .....	1063
A. Overhead Is Deductible .....	1064
1. The Second Circuit .....	1065
2. Ninth Circuit district courts .....	1067
B. Overhead Is Not Deductible .....	1067
C. Overhead Is Not Deductible for Willful Infringers .....	1069
D. Unclear as to When Overhead Is Deductible .....	1070
1. First Circuit .....	1071
2. Fifth Circuit.....	1072
3. Sixth Circuit .....	1072
4. Ninth Circuit.....	1073
5. Restatement (Third) .....	1074
III. THE TRUST ANALOGY.....	1075
IV. PURPOSES OF DISGORGEMENT .....	1080
A. Utility and Deterrence .....	1081
B. Punishment .....	1084
C. Corrective Justice .....	1087
D. Mixed Purposes.....	1090
V. ALLOCATING OVERHEAD TOWARD THE PROFITS OF INFRINGEMENT .....	1091
A. The Coercive View of Overhead Allocation.....	1092

B. The Punitive View of Overhead Allocation.....	1095
C. The Corrective-Justice View of Overhead Allocation...	1096
1. Calculation of profits.....	1096
2. Burdens of proof.....	1098
3. Profits calculation in related contexts.....	1100
4. The plaintiff's entitlement to the profits .....	1102
VI. CONCLUSION .....	1107

## I. INTRODUCTION

On March 10, 2015, a California jury determined that the Grammy-nominated song “Blurred Lines,” by Robin Thicke, Pharrell Williams, and T.I., infringed the copyright in Marvin Gaye’s “Got to Give It Up.”<sup>1</sup> Of the almost \$7.4 million awarded in the jury verdict, \$4 million was awarded as actual damages to compensate Gaye’s estate, while the remaining \$3.4 million was awarded to disgorge (that is, to take away) the infringers’ profits.<sup>2</sup>

The law of remedies usually looks to the plaintiff’s rightful position in determining a monetary award,<sup>3</sup> so the defendant-oriented framing of disgorgement (and of restitution more generally) is somewhat unusual in the law of remedies. Because of this unusual approach, disgorgement of a defendant’s profits is, at times, a controversial remedy.<sup>4</sup> One such controversy relates to how to calculate those profits. In particular, courts disagree about whether to allocate overhead—those expenses not directly attributable to

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1. Ann Oldenburg, *‘Blurred Lines’ Jury Finds for Marvin Gaye*, USA TODAY (Mar. 11, 2015, 3:04 PM), <http://www.usatoday.com/story/life/music/2015/03/10/blurred-lines-trial-verdict/24492431/>.

2. Special Verdict at 2, *Williams v. Bridgeport Music Inc.*, No. CV13-06004-JAK (AGRx) (C.D. Cal. Mar. 10, 2015), ECF No. 320.

3. See Samuel L. Bray, *The System of Equitable Remedies*, 63 UCLA L. REV. 530, 535 (2016).

4. See Dane S. Ciolino, *Reconsidering Restitution in Copyright*, 48 EMORY L.J. 1, 29–30, 35–40, 61–63 (1999) (criticizing generally disgorgement in copyright); Andrew Kull, *Disgorgement for Breach, the “Restitution Interest,” and the Restatement of Contracts*, 79 TEX. L. REV. 2021, 2022 (2001) (discussing disgorgement as a remedy for breach of contract).

particular products<sup>5</sup>—against the revenues of an infringing product in order to determine an infringer’s profits.<sup>6</sup>

The allocation of overhead was a source of dispute between the parties in the “Blurred Lines” case,<sup>7</sup> and the question has likewise divided federal courts.<sup>8</sup> Some circuits permit an infringer’s profits to be reduced by a proportionate share of overhead expenses,<sup>9</sup> while other circuits have held that overhead expenses cannot be used to offset revenues in calculating profits,<sup>10</sup> at least for willful wrongdoers.<sup>11</sup> The decision of whether to allocate overhead can significantly impact the plaintiff’s recovery.<sup>12</sup> For example, in the “Blurred Lines” case, the allocation of overhead would have made a difference of about \$7 million.<sup>13</sup> The district court ultimately concluded that overhead would

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5. *Overhead*, BLACK’S LAW DICTIONARY (10th ed. 2014).

6. *See, e.g.*, 4 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 14.03[C][3] (Matthew Bender, rev. ed. 2017) (“When infringement is deliberate, some courts appear to deny a deduction of overhead, but others are not convinced.”); Mark P. Gergen, *Causation in Disgorgement*, 92 B.U. L. REV. 827, 843 (2012).

7. *See* Williams v. Bridgeport Music, Inc., No. LA CV13-06004 JAK (AGRx), 2015 WL 4479500, at \*26, \*25 n.21 (C.D. Cal. July 14, 2015); Joint [Proposed] Jury Instructions at 23–24, Williams v. Bridgeport Music, Inc., No. CV13-06004-JAK (AGRx) (C.D. Cal. Jan. 21, 2015), ECF No. 223. References to the docket of *Williams v. Bridgeport Records* are hereinafter cited as *Blurred Lines Case*, ECF No. —, at [Page(s)].

8. *See* 4 NIMMER & NIMMER, *supra* note 6, § 14.03[C][3].

9. *See, e.g.*, Hamil Am., Inc. v. GFI, 193 F.3d 92, 106 (2d Cir. 1999). Overhead and fixed costs are not identical, although they overlap. *See Overhead*, BLACK’S LAW DICTIONARY (10th ed. 2014); *see also* Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166, 1171 (6th Cir. 1980) (“Expenses which are generally categorized as overhead, such as administrative salaries and utilities, have been broken down by the parties into fixed and variable expenses according to whether the incremental production of [the infringing work] actually affected the amount of the expense.”); Hamil Am., Inc. v. SGS Studio, Inc., No. 95 Civ. 2513(JSM), 1998 WL 19991, at \*2 (S.D.N.Y. Jan. 21, 1998), *aff’d in part, rev’d in part sub nom.* Hamil Am., Inc. v. GFI, 193 F.3d 92 (2d Cir. 1999) (“Part of the difficulty of determining whether ‘overhead’ should be deducted arises from the fact that the term ‘overhead’ embraces a variety of expenses . . .”).

10. *See, e.g.*, Taylor v. Meirick, 712 F.2d 1112 (7th Cir. 1983).

11. *See, e.g.*, Saxon v. Blann, 968 F.2d 676, 681 (8th Cir. 1992).

12. *See, e.g., id.* (refusal to allocate overhead resulted in award roughly fourteen times what the award would have been with overhead allocation).

13. Eriq Gardner, *‘Blurred Lines’ Trial Reveals How Much Money Robin Thicke’s Song Made*, HOLLYWOOD REP. (Mar. 3, 2015, 10:54 AM), <http://www.hollywoodreporter.com/thr-esq/blurred-lines-trial-reveals-how-778884> (describing the testimony of a Universal Music executive that overhead costs for the song were about \$7 million).

not be allocated if the counter-defendants were found to have willfully infringed.<sup>14</sup> But this decision represents only one possible approach.

In this Article, I survey the circuits' varied approaches to overhead allocation in copyright disgorgement. I also identify the potential purposes underlying the disgorgement remedy and, after evaluating each of those purposes, assess the propriety of overhead allocation under these various purposes. Next, I discuss the reasons for the disagreement surrounding the allocation of overhead. In the end, I contend that a proper determination of whether to allocate overhead should turn not on the defendant's willfulness in infringement but instead on the defendant's hypothetical activities in a counterfactual of non-infringement.

## II. VARIOUS APPROACHES

The awarding of profits is a statutory remedy enacted in 1909,<sup>15</sup> although courts disgorged infringers' profits in copyright infringement actions long before the statute was enacted.<sup>16</sup> Copyright laws permit a copyright owner to recover not only actual damages (e.g., lost sales) but also "any profits of the infringer that are attributable to the infringement," subject to a prohibition on a double recovery.<sup>17</sup> The statute also specifies the burden-shifting approach that applies to a copyright disgorgement claim: "[T]he copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses."<sup>18</sup> This measure of recovery and burden-shifting approach stem from a traditional trust-accounting formula.<sup>19</sup>

The statute does not define "deductible expenses," leaving courts to sort through the infringer's expenses to determine which are

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14. *Williams v. Bridgeport Music, Inc.*, No. LA CV13-06004 JAK (AGRx), 2015 WL 4479500, at \*26 (C.D. Cal. July 14, 2015).

15. *See* 17 U.S.C. § 504 (2012).

16. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940).

17. 17 U.S.C. § 504.

18. *Id.*

19. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 (AM. LAW. INST. 2011) [hereinafter RESTATEMENT (THIRD)].

deductible and which are not.<sup>20</sup> Some deductions are uncontroversial. For example, variable costs of the infringing products are deductible—the revenues generated by an infringing book will be reduced by the costs of the paper, ink, and cover of each book sold.<sup>21</sup> Other expenses are indisputably not deductible—the infringer cannot offset its revenues by costs wholly unconnected with the infringement.<sup>22</sup> The disagreement surrounds whether to allow infringers to deduct overhead costs connected to the infringement. In *Williams*, for example, the defendants sought to set off overhead costs such as salaries and fringe benefits of studio personnel who worked on the song, as well as “rent, utilities, dues and subscriptions, trade industry dues, legal expenses and things of that nature.”<sup>23</sup> The courts’ various positions with respect to the allocation of overhead—including the position taken by the court in *Williams*—are explored in the following sections.

#### A. Overhead Is Deductible

Some courts allow infringers to deduct overhead from the calculation of profits to be disgorged, regardless of whether the infringement was willful. These courts reason that overhead that contributed to the manufacture or sale of the infringing product is as necessary to the infringement as any variable cost (which is always deductible), and that, consequently, this overhead should be deducted

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20. For cases in addition to the ones discussed in this Part, see Alois Valerian Gross, Annotation, *Measure of Damages and Profits to Which Copyright Owner Is Entitled Under 17 USCS § 504(b)*, 100 A.L.R. Fed. 258, § 54, at 387–97 (1990 & Supp. 2014).

21. See, e.g., Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166, 1171 (6th Cir. 1980); Lee Valley Tools, Ltd. v. Indus. Blade Co., 288 F.R.D. 254, 268 (W.D.N.Y. 2013) (collecting cases, including copyright cases, for the proposition that infringers are “entitled to deduct the variable costs it incurs to manufacture or sell the infringing product so long as it can prove the costs were directly related to the infringing product”) (trademark case).

22. *Hamil Am. Inc. v. GFI*, 193 F.3d 92, 107 (2d Cir. 1999) (requiring the infringer to demonstrate a nexus between the sales of infringing goods and the expense for which the deduction is sought); *Aitken, Hazen, Hoffman, Miller, P. C. v. Empire Const. Co.*, 542 F. Supp. 252, 264 (D. Neb. 1982) (“The rule is that the overhead expenses which assist in the production of an infringing work are deductible from the gross profit of the infringer.”); George P. Roach, *Restitution Rollout: The Restatement (Third) of Restitution & Unjust Enrichment: Counter-Restitution for Monetary Remedies in Equity*, 68 WASH. & LEE L. REV. 1271, 1298 (2011).

23. *Blurred Lines Case*, *supra* note 7, ECF No. 351, at 59.

in calculating profits from the infringement.<sup>24</sup> The Second Circuit takes this approach, as have some district courts in the Ninth Circuit.

### 1. *The Second Circuit*

In *Hamil America v. GFI*, the Second Circuit held that even conscious wrongdoers should be allowed to allocate overhead as expenses of the infringing product.<sup>25</sup> The district court opined that the proper approach to overhead deduction was the “incremental approach,” which deducts only costs actually increased by the infringing production.<sup>26</sup> The court was concerned that “willful infringers should not be permitted to subsidize the sale of legitimate goods with the sale of infringing goods ‘by passing part of its fixed cost on to the copyright holder.’”<sup>27</sup>

The Second Circuit reversed,<sup>28</sup> rejecting the district court’s reliance on the infringer’s willfulness to deny overhead allocation.<sup>29</sup> Rather than a “hard and fast rule denying all overhead deductions to willful infringers,” the Second Circuit held that willful infringers’ overhead allocation was subject to the same approach as other infringers.<sup>30</sup> Specifically, it noted that its prior cases had permitted overhead to be allocated to the infringing product as long as it satisfied a two-step approach: first, the overhead must be sufficiently connected to the infringing product; and second, the allocation method must be reasonable.<sup>31</sup> Nevertheless, the Second Circuit shared “the district court’s concern that willful infringers should not be permitted to subsidize the sale of legitimate goods with the sale of infringing goods

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24. See *Hamil*, 193 F.3d at 104.

25. *Id.* at 96.

26. *Hamil Am., Inc. v. SGS Studio, Inc.*, No. 95 Civ. 2513(JSM), 1998 WL 19991, at \*2 (S.D.N.Y. Jan. 21, 1998), *aff’d in part, rev’d in part sub nom.* *Hamil Am. Inc. v. GFI*, 193 F.3d 92 (2d Cir. 1999). The district court contrasted the “incremental approach” with the “full absorption” approach, which proportionately deducts all overhead expenses, including fixed costs.

27. *Hamil*, 193 F.3d at 106 (quoting *Hamil*, 1998 WL 19991, at \*2).

28. *Id.* at 108–09.

29. *Id.* at 106–07. The earlier circuit precedent that the Second Circuit primarily relied on was *Sheldon v. Metro-Goldwyn Pictures, Corp.*, a case involving a movie that was made based on the plaintiff’s screen play. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d 45 (2d Cir. 1939), *aff’d*, 309 U.S. 390 (1940).

30. *Id.* at 106.

31. *Id.* at 104–06.



by ‘passing . . . fixed cost on to the copyright holder.’”<sup>32</sup> Accordingly, in an apparent effort to differentiate cases of conscious wrongdoing from inadvertent wrongdoing, the court held that the evaluation “must be applied with particular rigor in the case of willful infringement.”<sup>33</sup>

It is unclear exactly how the Second Circuit’s particular-rigor-for-willful-infringement approach differs from the general application of the two-step approach.<sup>34</sup> The court noted that all infringers bear the burden of establishing a sufficient nexus between the claimed overhead and the infringing product but stressed that, in cases of willful infringement, the district court “should give extra scrutiny” to the connection between the overhead and the infringing product.<sup>35</sup> The Second Circuit also noted that, in any disgorgement case, the district court “must determine that the particular allocation formula is optimal and sound” but that willful infringers “should be held to a particularly high standard of fairness” (whatever that means). The court concluded with an instruction that lower courts “should not hesitate to reject a formula which allows the willful infringer to deduct more of its overhead than was directly implicated in the manufacture of the infringing product.”<sup>36</sup> In the end, the Second Circuit seems to have said that the district court should do its job in every case but that it should do its job particularly well in cases of willful infringement.<sup>37</sup>

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32. *Id.* at 106–07.

33. *Id.* at 107.

34. See George P. Roach, *Counting the Beans: Unjust Enrichment and the Defendant’s Overhead*, 16 TEX. INTELL. PROP. L.J. 483, 567 (2008) (“[I]t seems difficult to conceive that a court would structure the review of evidence on the basis on [sic] graduated levels of scrutiny.”).

35. *Hamil*, 193 F.3d at 107. The court does not articulate how the “extra scrutiny” should manifest itself in the allowance of overhead, nor does the court articulate a different standard that the district court should apply.

36. *Id.*

37. District courts in the Second Circuit have addressed the issue, both before and after *Hamil America*. In *Warner Bros. v. Gay Toys, Inc.*, the district court discussed the “incremental approach” (no allocation of overhead) with the “full absorption approach” (allocation of overhead), and concluded the Second Circuit precedent compelled the full absorption approach. *Warner Bros., v. Gay Toys, Inc.*, 598 F. Supp. 424, 429 (S.D.N.Y. 1984). Oddly, the Second Circuit seems *less favorably* disposed to the overhead of those who offer emergency medical treatment than to the overhead of willful copyright infringers. See Roach, *supra* note 22, at 1296–97.

## 2. Ninth Circuit district courts

In *ZZ Top v. Chrysler Corp.*, the district court in the Western District of Washington held that the defendant could allocate its overhead, even if its infringement was willful.<sup>38</sup> The court worried that a contrary rule would award the copyright owner “more than just profits,” and the infringer “would not only be deprived of whatever benefit it derived from the infringement, as was the apparent intent of Congress, but would also suffer affirmative punishment.”<sup>39</sup>

The Northern District of California reached a similar conclusion in *Oracle America, Inc. v. Google Inc.*<sup>40</sup> There, Oracle claimed that Google infringed its copyright in the Java programming platform, and Google sought to preclude evidence of willfulness from the trial.<sup>41</sup> Oracle argued that willfulness would be relevant to the issue of whether overhead could be deducted in disgorgement.<sup>42</sup> The district court reviewed Ninth Circuit case law on the subject and surveyed cases from other circuits as well.<sup>43</sup> It acknowledged that another district court in California had held that willful infringers could not deduct overhead,<sup>44</sup> but it ultimately disagreed with that conclusion.<sup>45</sup> The court held that all non-tax “overhead deductions will be allowed regardless of willfulness” as long as the claimed expenses were “of actual assistance in the production, distribution, or sale of the infringing product.”<sup>46</sup>

### B. Overhead Is Not Deductible

Other courts have held that overhead should not be deducted in calculating even an innocent infringer's profits, at least as long as the infringement did not actually increase the overhead costs. These courts maintain that allowing such a deduction would permit the infringer to subsidize legitimate activities through infringement and

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38. *ZZ Top v. Chrysler Corp.*, 70 F. Supp. 2d 1167, 1169 (W.D. Wash. 1999).

39. *Id.* at 1168.

40. *Oracle Am., Inc. v. Google Inc.*, 131 F. Supp. 3d 946 (N.D. Cal. 2015).

41. *Id.* at 948.

42. *Id.* at 949.

43. *Id.* at 951–54.

44. *Id.* at 954.

45. *Id.* at 954–55.

46. *Id.* at 955.

would not create an appropriate deterrent to infringement. These courts also note that the infringement is not a but-for cause of these costs and therefore they should not be deducted. The Seventh Circuit has taken this approach, along with district courts in the Ninth and Tenth Circuits.

In *Taylor v. Meirick*,<sup>47</sup> a copyright infringement action involving topographical maps, the Seventh Circuit adopted the incremental approach,<sup>48</sup> preventing the infringer from deducting overhead as an expense in the calculation of profits from infringement. Judge Posner, writing for the court, articulated a deterrence-based view of disgorgement, noting that disgorgement “discourages infringement” because it eliminates the incentive to profitably infringe rather than to seek a license from the copyright holder.<sup>49</sup> Thus, to properly deter infringement, fixed overhead should not be allocated toward the infringing products. In other words, the court made the deduction of overhead turn not on the defendant’s willfulness but instead on whether the costs would have been incurred even in the absence of infringement.<sup>50</sup> “Costs that would be incurred anyway should not be subtracted, because by definition they cannot be avoided by curtailing the profit-making activity.”<sup>51</sup>

In *JBJ Fabrics, Inc. v. Mark Industries, Inc.*,<sup>52</sup> a judge in the Central District of California opined that overhead should be deducted on the full absorption basis,<sup>53</sup> but the court believed that Ninth Circuit precedent tugged in favor of Judge Posner’s reasoning in *Taylor*. Thus, the court held that overhead may be deducted only if it was actually

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47. *Taylor v. Meirick*, 712 F.2d 1112 (7th Cir. 1983).

48. See Stephen E. Margolis, *The Profits of Infringement: Richard Posner v. Learned Hand*, 22 BERKELEY TECH. L.J. 1521, 1540 (2007).

49. *Taylor*, 712 F.2d at 1120.

50. *Id.* at 1121.

51. *Id.* Shortly after *Taylor*, Judge Posner, sitting as a district judge by designation, reached a similar conclusion in a different copyright case. See *Deltak, Inc. v. Advanced Sys., Inc.*, 574 F. Supp. 400, 412 (N.D. Ill. 1983), *vacated*, 767 F.2d 357 (7th Cir. 1985) (“[T]he only costs that would be relevant in deciding what profits ASI made on these contracts would be short-run variable costs, for those are the only costs it would have saved by not infringing.”).

52. *JBJ Fabrics, Inc. v. Mark Indus., Inc.*, No. CV 86-4881 FFF, 1987 WL 47381, at \*6 (C.D. Cal. Nov. 5, 1987).

53. *Id.* (“If left to its own devices, the Court would think that a reasonable approach is that overhead expenses should be deducted” because to disregard overhead would “fly in the face of the way businessmen compute their profits and determine whether a particular item was profitable or not.”).

increased by the infringement.<sup>54</sup> The Tenth Circuit has not specifically spoken to the issue, but a judge in the District of Kansas followed the Seventh Circuit's approach in *Taylor*, holding that fixed costs were not deductible from revenues in calculating an infringer's profit.<sup>55</sup> The court held that the deductibility of these costs would not change regardless of whether the infringement was willful—the costs were not deductible even if the infringement was unintentional.<sup>56</sup>

### C. Overhead Is Not Deductible for Willful Infringers

Still other courts predicate the deductibility of overhead on the willfulness *vel non* of the infringement. Under this approach, inadvertent infringers may deduct overhead in calculating the profits of infringement, but willful infringers may not. These courts are concerned about the incentives that would exist for willful infringement if these infringers could shift the overhead costs for their legitimate products onto the infringing products, thereby subsidizing the legitimate business through infringement.<sup>57</sup> The Eighth Circuit and district courts in the Third and Ninth Circuits have taken this approach.

In *Jarvis v. A&M Records, Inc.*, a district court in the Third Circuit drew a distinction between willful infringement and non-willful infringement, holding that “[e]ven overhead may be deducted, provided that the defendant’s violation of plaintiff’s copyright was not willful. However, if defendant’s conduct is willful, overhead may not be deducted.”<sup>58</sup> In *Allen-Myland, Inc. v. IBM Corp.*, the Eastern

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54. *Id.*

55. *In re Indep. Serv. Orgs. Antitrust Litig.*, 23 F. Supp. 2d 1242, 1251 (D. Kan. 1998). The court preferred to describe the deductible costs as variable and the non-deductible costs as fixed, rather than referring to overhead because, on the evidence provided, some potentially variable costs had been characterized as “overhead.” *Id.*

56. *Id.*

57. *See, e.g.*, *Hamil Am., Inc. v. SGS Studio, Inc.*, No. 95 Civ. 2513(JSM), 1998 WL 19991, at \*2 (S.D.N.Y. Jan. 21, 1998), *aff'd in part, rev'd in part sub nom.* *Hamil Am. Inc. v. GFI*, 193 F.3d 92 (2d Cir. 1999).

58. *Jarvis v. A & M Records, Inc.*, 827 F. Supp. 282, 294 (D.N.J. 1993) (citation omitted).

District of Pennsylvania tentatively reached the same conclusion, speculating that analogous Third Circuit precedent required it.<sup>59</sup>

Similarly, the Eighth Circuit affirmed a district court's refusal to allocate overhead toward the infringing products in *Saxon v. Blann*.<sup>60</sup> In that case, allocation of overhead would have reduced the recoverable profits from \$19,843.45 to \$1,426.70.<sup>61</sup> The district court refused the defendants' urging to allocate overhead, and the Eighth Circuit, noting that the district court had determined the defendants to be willful infringers, agreed.<sup>62</sup> The Eighth Circuit held that "[o]verhead may not be deducted from gross revenues to arrive at profits when an infringement was deliberate or willful."<sup>63</sup> Thus, the court implied, but did not hold, that overhead would be deductible for non-willful infringers.

The Central District of California judge in *Williams v. Bridgeport Music* recognized that the Ninth Circuit had not explicitly ruled on the issue but determined that the circuit court would most likely follow "other sister circuits" in holding overhead unallocable in cases of willful infringement.<sup>64</sup> As a precaution, however, the trial judge separated out the amount of overhead in the jury verdict form so that a reversal by the Ninth Circuit would not require a retrial.<sup>65</sup>

#### *D. Unclear as to When Overhead Is Deductible*

A number of courts have addressed the question of overhead allocation without reaching a clear decision regarding what circumstances, if any, permit overhead to be deducted in calculating the profits of infringement. Some courts, for example, have discussed in dicta whether willfulness should affect overhead allocation, but have not directly answered the question. Courts that have discussed the

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59. *Allen-Myland, Inc. v. IBM Corp.*, 770 F. Supp. 1014, 1025 & n.19 (E.D. Pa. 1991) (discussing the trademark case of *Century Distilling Co. v. Continental Distilling Corp.*, 205 F.2d 140 (3d Cir. 1953)).

60. *Saxon v. Blann*, 968 F.2d 676, 681 (8th Cir. 1992).

61. *Id.* at 680–81.

62. *Id.* at 681.

63. *Id.*

64. *Williams v. Bridgeport Music, Inc.*, No. LA CV13-06004 JAK (AGRx), 2015 WL 4479500, at \*26, \*25 n.21 (C.D. Cal. July 14, 2015); *Blurred Lines Case*, *supra* note 7, ECF No. 339, at 32–33.

65. *Blurred Lines Case*, *supra* note 7, ECF No. 339, at 34–36.

issue without resolving it include the First Circuit, the Fifth Circuit, the Sixth Circuit, and the Ninth Circuit. In addition, the Third Restatement does not take a clear position on this question.

*1. First Circuit*

In *Sammons v. Colonial Press, Inc.*,<sup>66</sup> the First Circuit distinguished between copyright damages—oriented toward the plaintiff's loss—and an accounting for the defendant's profits—oriented toward the defendant's gain. In doing so, the court recognized that the infringer's sales do not necessarily deprive the plaintiff of sales; the parties may compete in non-overlapping markets such that the "profits which were made by the infringer may bear no relation to the damages suffered by the copyright proprietor," and an accounting for the defendant's profits is available even if the copyright holder had made no effort to commercialize its copyright.<sup>67</sup>

The court also recognized that overhead allocation can result in a very real advantage to the defendant, making the defendant better off as a result of the infringement because "the fixed general overhead expenses . . . presumably would have been borne by him even had he not participated in the infringement complained of."<sup>68</sup> "In such a case," the court continued, "it would be difficult to deny that the infringer has reaped a benefit in dollars and cents from the infringement, for which he ought to be accountable."<sup>69</sup> The court then raised the issue of willfulness, speculating that "[p]ossibly a deduction for overhead should be allowed in such a case when the infringement is innocent and denied when the infringement is conscious and deliberate."<sup>70</sup> Ultimately, however, the court remained noncommittal because the plaintiff did not raise the issue of the allocability of overhead as a general matter—instead, the plaintiffs' complaint went to the sufficiency of the evidence.<sup>71</sup> The court,

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66. *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 345 (1st Cir. 1942).

67. *Id.*

68. *Id.* at 348 ("Manufacturers are frequently glad to make a contract at a price which yields no net profit on a strict cost accounting basis but which does yield sufficient profit to carry a portion of the inescapable overhead.").

69. *Id.*

70. *Id.*

71. *Id.* at 348–49.

therefore, assumed without deciding that “a deduction for overhead is allowable if properly established by proof.”<sup>72</sup>

## 2. *Fifth Circuit*

In *Maltina Corp. v. Cawy Bottling Co.*, the Fifth Circuit discussed allocation of overhead in a case of willful trademark infringement.<sup>73</sup> The district court had refused to allocate overhead toward the infringing products, noting that “the unlawful venture increased the gross profits without swelling the gross expenses.”<sup>74</sup> The Fifth Circuit agreed, affirming the district court’s decision because of the absence of any evidence that the infringing product actually increased overhead expenses.<sup>75</sup> The Fifth Circuit went on to conclude that overhead could not be allocated “when the sales of an infringing product constitute only a small percentage of total sales.”<sup>76</sup> Though unclear, it appears that the court based this rule on a presumption (perhaps irrebuttable) that when the infringing product’s sales are only a small percentage of the infringer’s overall sales, overhead is likely not increased by the infringing product.<sup>77</sup>

## 3. *Sixth Circuit*

The Sixth Circuit addressed the issue of overhead allocation in a design patent case.<sup>78</sup> The court first recognized conflicting arguments

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72. *Id.* at 349.

73. *Maltina Corp. v. Cawy Bottling Co.*, 613 F.2d 582, 586 (5th Cir. 1980). The language of the Lanham Act differs slightly from the language of the Copyright Act. *Compare* 15 U.S.C. § 1117(a) (2012), *with* 17 U.S.C. § 504(b) (2012). In the general theory of restitution, disgorgement is reserved for conscious wrongdoers, and although some have expressed concern that language in the trademark statutes has altered this default, the general consensus is that conscious wrongdoing remains a predicate for disgorgement under trademark laws. *See* DOUGLAS LAYCOCK, *MODERN AMERICAN REMEDIES: CASES AND MATERIALS* 525 (Concise 4th ed., 2012).

74. *Maltina*, 613 F.2d at 586.

75. *Id.*

76. *Id.*

77. *Id.* (“Accordingly, we think it unlikely, especially in the absence of any evidence to the contrary, that Cawy’s production of ‘Cristal’ increased its overhead expenses.”); *see also* *Kamar Int’l, Inc. v. Russ Berrie & Co.*, 752 F.2d 1326, 1332 (9th Cir. 1984) (discussing this portion of *Maltina*).

78. *Schnadig Corp. v. Gaines Mfg. Co.*, 620 F.2d 1166, 1172 (6th Cir. 1980). Disgorgement, though statutorily eliminated as a remedy for infringement of utility patents,

related to but-for causation. From the infringer's perspective, the fixed expenses "were neither caused nor increased by the infringing production," so that "it may be argued that the infringer should not be permitted to avoid the expense by passing it on" to the plaintiff.<sup>79</sup> But, from the plaintiff's perspective, the infringing products "could not have been produced without expenses for utilities, administrative salaries, building space and the like being incurred," so that "the fixed expenses are as necessary to the infringing production as are the variable expenses."<sup>80</sup> In light of this conflict, the court concluded, "Neither case law nor logic provides a clear rule for the proper treatment of fixed expenses in computing an award of profits."<sup>81</sup> Thus, the court decided that the issue could not be determined by clear-cut rules, but was a fact question that would vary from case to case.<sup>82</sup>

#### 4. Ninth Circuit

The Ninth Circuit considered the disgorgement question in *Kamar International, Inc. v. Russ Berrie & Co.*<sup>83</sup> The court disagreed with the Fifth Circuit's holding in *Maltina*, and it "decline[d] to adopt a legal rule disallowing all overhead deductions merely because the sales of the infringing goods constitute a small percentage of total sales."<sup>84</sup> The court recognized that "[a] rule disallowing such expenses has the advantage of not allowing an infringer to reduce damages by deducting fixed overhead costs the infringer would have borne even without his sales of infringing goods."<sup>85</sup> But the court was also concerned that such a rule could allow the copyright holder to subsidize its profits through the infringer's overhead:

If the copyright owner currently uses his fixed overhead to capacity, he would obtain by lawsuit net profits greater than he could have earned. Not only will the profits not cost him an increase in his own

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remains a permissible remedy for infringement of design patents. *See id.* at 1172–73 ("Prior to 1946 a utility patentee, like a design patentee today, could recover an infringer's profits.")

79. *Id.* at 1172.

80. *Id.*

81. *Id.*

82. *Id.* at 1174–75.

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

84. *Id.*

85. *Id.*



overhead; he will actually receive a premium representing the disallowance of the infringer's overhead.<sup>86</sup>

After surveying the case law, the court ultimately permitted the allocation of overhead to infringing sales without deciding whether willful infringement would be grounds to deny allocation,<sup>87</sup> given that the district court had rejected a finding of willful infringement.<sup>88</sup>

In *Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc.*,<sup>89</sup> the Ninth Circuit again left open the question of whether willful infringers could deduct overhead from gross revenues to arrive at profits.<sup>90</sup> The district court had found that the infringement was not conscious and deliberate, and the Ninth Circuit simply noted that, “at least where the infringement was not willful, conscious, or deliberate,” overhead may be deducted.<sup>91</sup>

### 5. Restatement (Third)

The black letter of the Restatement (Third) of Restitution and Unjust Enrichment does not take a position on the allocation of overhead,<sup>92</sup> though the comments suggest that fixed overhead ordinarily should not be allocated.<sup>93</sup> The Third Restatement's section on general disgorgement reflects the concern that allocation of fixed overhead to the infringing conduct will render the defendant more profitable than it would have otherwise been.<sup>94</sup> In the section directed

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86. *Id.*

87. *Id.*

88. *Id.* at 1331.

89. *Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc.*, 772 F.2d 505 (9th Cir. 1985).

90. *Id.* at 515.

91. *Id.* Interestingly, the Eighth Circuit cited this dicta from *Frank Music* as supporting its own conclusion that “[o]verhead may not be deducted . . . when an infringement was deliberate or willful.” *Saxon v. Blann*, 968 F.2d 676, 681 (8th Cir. 1992).

92. See RESTATEMENT (THIRD), *supra* note 19, § 51(5)(c) (noting that a “conscious wrongdoer or a defaulting fiduciary may be allowed a credit for money expended in acquiring or preserving the property or in carrying on the business,” but that this defendant “will ordinarily be denied any credit for contributions in the form of services, or for expenditures incurred directly in the commission of [the] wrong”).

93. *Id.* § 51 cmt. h (“[T]he defendant will not be allowed to deduct expenses (such as ordinary overhead) that would have been incurred in any event, if the result would be that defendant's wrongful activities—by defraying a portion of overall expenses—yield an increased profit from defendant's operations as a whole.”).

94. *Id.*

specifically to intellectual property rights, the Restatement echoes this concern.<sup>95</sup> Although the Restatement does not directly take a normative position about what courts should do, it acknowledges that overhead deductions may properly be limited to “variable costs—thereby avoiding an improper subsidy from the wrongful activity to the defendant’s overall cost structure.”<sup>96</sup> The comments to the Third Restatement do not discuss willfulness in this context, but the illustrations seem to offer a *Hamil America* approach, in which both willful and non-willful infringers are permitted to allocate overhead, but willful infringers are held to a more exacting standard of proof.<sup>97</sup> The Third Restatement instructs courts to “make such allocations” and “recognize such credits or deductions” as “reason and fairness dictate,” consistent with the goal of disgorging profits without imposing a penalty.<sup>98</sup> Unsurprisingly, the Third Restatement has been criticized as inconsistent in its approach to the allocation of overhead in disgorgement cases.<sup>99</sup>

### III. THE TRUST ANALOGY

The Third Restatement, like many courts,<sup>100</sup> has analogized disgorgement claims to claims against trustees who have defaulted on fiduciary obligations.<sup>101</sup> Indeed, the Third Restatement points out that “the notion of treating the infringer as a trustee under a duty to account has been codified in the remedial provisions of the Copyright Act.”<sup>102</sup> The “characterization of an infringer as a trustee ex maleficio”

95. *Id.* § 42.

96. *Id.* § 42 cmt. i.

97. *Id.* § 42 cmt. i, illus. 21–22, reporter’s note i.

98. *Id.* § 51(3)–(4).

99. See Roach, *supra* note 22, at 1294–95 (“The position of the Third Restatement on the right to prove counter-restitution is both mixed and unclear.”).

100. See, e.g., *Packet Co. v. Sickles*, 86 U.S. (19 Wall.) 611, 617 (1873) (“The rule in suits in equity . . . is that of converting the infringer into a trustee for the patentee as regards the profits thus made.”); *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 345 (1st Cir. 1942) (“[T]o prevent unjust enrichment the infringer was treated as a trustee ex maleficio of his ill gotten gains.”); *Christensen v. Nat’l Brake & Elec. Co.*, 10 F.2d 856, 861 (E.D. Wis. 1924) (“[W]hen we test an infringer as one who is liable to account for profits upon the theory that he is a trustee ex maleficio, we are bound at once to look to both the debit and the credit side of trust obligation.”) (patent infringement).

101. RESTATEMENT (THIRD), *supra* note 19, § 51 reporter’s note i.

102. *Id.*

arises because the infringer “is viewed as one who has profited through wrongful appropriation of a right, and is therefore called upon to account” to the plaintiff.<sup>103</sup>

The trust analogy helps to distinguish copyright infringement cases from some other restitution cases, such as those of specific restitution. In specific restitution, no trust—constructive or otherwise—is necessary. Plaintiffs simply recover their property in the hands of the defendant. That property may have been altered in some way (and, to the extent it has lost value, the plaintiff will have a damages claim for that lost value), but there is no need to consider the defendant a “trustee” of the plaintiff’s property.<sup>104</sup> In these cases, the willfulness of the wrongdoer is relevant because it determines whether the wrongdoer may assert a counter-restitutionary claim against the property holder.<sup>105</sup>

When a rightful owner recovers property through specific restitution, a party who has mistakenly improved that property has a separate claim in restitution against the owner. In other words, when the defendant has, at its own expense, inadvertently added value to the plaintiff’s property, the defendant has a restitutionary claim against the plaintiff. Imagine, for example, that *A*, relying on an errant survey, mistakenly builds a hotel on *B*’s property and serves several guests before *B* learns of the hotel.<sup>106</sup> *B* has several potential claims against *A*, including a claim to retake possession of the property and a claim to disgorge the hotel’s profits. But *A*, as a mistaken improver, has a counter-restitutionary claim against *B* because *B*’s property is now more valuable thanks to *A*’s expenditures.<sup>107</sup> If *B* kept the

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103. *Christensen*, 10 F.2d at 861–62.

104. As trusts were of equitable origin, the trust analogy—with its consequent recovery of the infringer’s profits—was available only incidentally with a request for an injunction. *Root v. Ry. Co.*, 105 U.S. 189, 207–08, 215–16 (1881).

105. ERNEST J. WEINRIB, *CORRECTIVE JUSTICE* 139–42 (2012); see also RESTATEMENT (THIRD), *supra* note 19, § 51 cmt. h (“[T]he defendants in these cases, in seeking a credit against liability to the claimant, are asserting what is in effect a restitutionary setoff or counterclaim. Although the transactions take various forms, in each case the defendant’s implicit counterclaim is an attempt to recover (through a credit against liability) the value to the claimant of benefits conferred without request.”).

106. This hypothetical is loosely based on the case of *Somerville v. Jacobs*, 170 S.E. 2d 805 (W. Va. 1969).

107. Whether and to what extent *B* can recover against *A* on his counter-restitutionary claim depends on many things, including the relative fault of the parties and whether *A* actually benefitted from *B*’s expenditures. See RESTATEMENT (THIRD), *supra* note 19, § 51.

improved property without any outlay on his own part, *B* would be unjustly enriched. Thus, *A* may pursue his unjust enrichment claim against *B* even if *A* negligently relied on the errant survey.

But, where one party *intentionally* improves the property of another at its own expense, that party usually has no claim in counter-restitution. The willful wrongdoer has “willingly taken the risk of losing the value of the benefit conferred on the owner.”<sup>108</sup> Stated differently, the willful wrongdoer is an “officious intermeddler” under the law,<sup>109</sup> and any benefits the wrongdoer confers are gratuitous. So, when the plaintiff claims in restitution for the wrongful appropriation of its property, the defendant has a counter-restitutionary claim for the value added to the property only if the defendant did not act intentionally.<sup>110</sup> Under this explanation of disgorgement, “[t]he idea of punishment, with its one-sided focus on the defendant, is entirely absent.”<sup>111</sup>

If this counter-restitution reasoning were applied to copyright cases, the willful infringer would be liable to the copyright holder for the infringing product's *gross revenues*, with no offset for even its variable expenses. Disgorgement would not be of the infringement-

108. WEINRIB *supra* note 105, at 140.

109. RESTATEMENT (THIRD), *supra* note 19, § 2(3); LAYCOCK, *supra* note 73, at 495; WEINRIB *supra* note 105, at 141.

110. Andrew Kull, *Restitution's Outlaws*, 78 CHI.-KENT L. REV. 17, 18 (2003); *see also* 1 GEORGE E. PALMER, THE LAW OF RESTITUTION § 3.12, at 303 (1978) (“[T]he true basis of the requirement is to prevent the unjust enrichment of the plaintiff, who is himself seeking restitution based on the defendant’s unjust enrichment.”).

111. WEINRIB, *supra* note 105, at 141. Similarly, coercion of future potential wrongdoers is not the driving force behind the refusal to allow counter-restitution claims by intentional wrongdoers. This explanation helps make sense of the Supreme Court’s decision in *E.E. Bolles Wooden-Ware Co. v. United States*, 106 U.S. 432 (1882), in which the Court affirmed the rule that a willful trespasser who severs timber from land is liable for the severed value of the timber rather than the lower pre-cut value. The Court remarked that holding the willful trespasser to the greater liability “punish[es] the fraud by fixing the person with the value of the whole of the property which he has so furtively taken.” *Id.* at 434. But, in *E.E. Bolles*, the Court extended this enhanced liability to a third-party who innocently bought the severed timber from the wrongdoer, despite the absence of any intent or otherwise culpable conduct on his part. *Id.* at 433. This makes sense only as the subrogation of the original trespasser’s counter-restitution claim, if any, onto the innocent buyer, who purchases subject to any claims by the rightful owner, which are in turn subject to any claims in counter-restitution the trespasser could have asserted against the owner. This cannot be the result of our desire to punish the innocent third-party buyer, but instead is the application of non-punitive and non-coercive restitutionary principles. *But see* Kull, *supra* note 110, at 23 (contending that restitution acts punitively by disallowing claims of conscious wrongdoers).

created profits, but of the infringement-created revenues. But this counter-restitution reasoning is most commonly applied in cases with claims seeking specific restitution of tangible property rather than those with claims seeking an accounting (disgorgement) incidental to injunctive relief.<sup>112</sup> In cases of the latter sort, it has been suggested that the trust analogy is more appropriate.<sup>113</sup>

The trust analogy rests on the fiction that the infringer deals with the copyright holder's property as a trustee and, as such, must account for any proceeds from the sale of the plaintiff's property.<sup>114</sup> "The idea behind the ascription of agency was that the only legal basis for selling what belongs to another is that the seller is acting as the owner's agent and therefore holds the proceeds on the owner's behalf."<sup>115</sup> Thus, as Professor Rounds explains, "Any profit that accrues to the trustee as a result of the trustee's unauthorized self-dealing must be turned over to the trust estate. On the other hand, the trustee is entitled to indemnity from the trust estate for reasonable expenses incurred in the course of administering the trust."<sup>116</sup> This trust analogy helps to distinguish copyright infringement from cases of specific restitution, and it sheds light on the relevance of the defendant's willfulness.

A trustee engaged in an unauthorized self-dealing transaction will be forced to disgorge the fruits of its misdealing, but even the defaulting trustee is permitted to reduce its liability by the expenses incurred in the transaction.<sup>117</sup> "Even for cases relating to disloyal

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112. Roach, *supra* note 34, at 514–15 (discussing timber or minerals severed from land, as well as stolen personal property). Indeed, timber and minerals have long been recognized as exceptions under claims at law. *Bishop of Winchester v. Knight* (1717) 24 Eng. Rep. 447, 448; 1 P. Wms. 406, 407. Roach says that "the innocent defendant that bought a stolen car will generally lose the car without compensation for any money expended to repair or improve the car." Roach, *supra* note 22, at 515. But this is not true in all jurisdictions; some provide the innocent defendant with a counter-restitution claim against the plaintiff for the market value of improvements to the property. *See Iacomini v. Liberty Mut. Ins. Co.*, 497 A.2d 854 (N.H. 1985).

113. *See* Roach, *supra* note 34, at 514–15.

114. *Burdell v. Denig*, 92 U.S. 716, 720 (1876) (stating, in a patent case, that an award of profits "applies eminently and mainly to cases in equity, and is based upon the idea that the infringer shall be converted into a trustee").

115. WEINRIB, *supra* note 105, at 127.

116. Charles E. Rounds, Jr., *Relief for IP Rights Infringement Is Primarily Equitable: How American Legal Education Is Short-Changing the 21st Century Corporate Litigator*, 26 SANTA CLARA COMPUTER & HIGH TECH. L.J. 313, 336–37 (2010).

117. 3 AUSTIN WAKEMAN SCOTT ET AL., SCOTT AND ASCHER ON TRUSTS § 18.1.2.6, at 1294–95 (5th ed. 2007); 4 *id.* § 22.2.1, at 1634–35; Roach, *supra* note 22, at 1288; Rounds,

fiduciaries—claims involving the highest level of concern for courts in equity—the disloyal trustee is entitled to indemnity for his reasonable expenses . . . .”<sup>118</sup> And just as even the consciously defaulting trustee may claim indemnity for expenses reasonably incurred to benefit the trust assets,<sup>119</sup> so too may the willful infringer.<sup>120</sup>

The trust analogy helps to explain why, in the Copyright Act, Congress limited the infringement remedy to disgorgement of profits (rather than all revenues), even for willful infringers.<sup>121</sup> The analogy also helps to explain another controversial aspect of the Copyright Act—the Act makes disgorgement available as an infringement remedy against even inadvertent infringers.<sup>122</sup> Congress believed that, “‘on reasoning as old as Aristotle,’ an infringer should disgorge any profits attributable to infringement, irrespective of his culpability.”<sup>123</sup> This belief is compatible with the trust analogy—just as the defaulting trustee uses something that in equity belongs to the beneficiary and so must relinquish any claim to the profits resulting from such use, the infringer uses something that belongs to the copyright holder and must relinquish the profits of this use.

The trust analogy helps to explain why Congress may have created disgorgement liability even for innocent infringers, but it does not answer the question of whether disgorged profits should be offset by an allocation of overhead toward the infringing products.

*supra* note 116, at 348–49 (citing 1 RESTATEMENT (SECOND) OF TRUSTS § 245 cmts. c–d (AM. LAW INST. 1957) [hereinafter 1 RESTATEMENT (SECOND)]).

118. Roach, *supra* note 34, at 538.

119. 1 RESTATEMENT (SECOND), *supra* note 117, § 245. The First Restatement of Restitution required a contracting party seeking rescission to restore any benefits received to the other party, whether the transfer was induced “by fraud . . . or mistake.” RESTATEMENT OF RESTITUTION: QUASI CONTRACTS & CONSTRUCTIVE TRUSTS § 177 cmt. c (AM. LAW INST. 1936).

120. 17 U.S.C. § 504(b) (2012) (providing for disgorgement of “profits”); Roach, *supra* note 34, at 521; *see* 1 RESTATEMENT (SECOND), *supra* note 117, §§ 244–45.

121. *See* 17 U.S.C. § 504(b).

122. *See* Ciolino, *supra* note 4, at 29–30; *id.* at 35–40, 61–63 (arguing that disgorgement in copyright infringement should be eliminated and that willful infringement should be deterred through exemplary damages). Disgorgement in patent is unavailable as a remedy. Caprice L. Roberts, *The Case for Restitution and Unjust Enrichment Remedies in Patent Law*, 14 LEWIS & CLARK L. REV. 653, 655 (2010). In trademark infringement, disgorgement turns on willfulness, at least under some courts’ analysis. *George Basch Co. v. Blue Coral, Inc.*, 968 F.2d 1532, 1540 (2d Cir. 1992).

123. Ciolino, *supra* note 4, at 39–40 (quoting BENJAMIN KAPLAN, AN UNHURRIED VIEW OF COPYRIGHT 72 (1967)).

To answer this question, we need to examine the purposes of the disgorgement remedy.

#### IV. PURPOSES OF DISGORGEMENT

Disgorgement became a statutorily authorized remedy for copyright infringement in 1909.<sup>124</sup> The statute allows a plaintiff to disgorge a defendant's profits even in cases of non-willful copyright infringement.<sup>125</sup> But long before disgorgement was a statutorily enacted copyright remedy, it was an equitable remedy that reached beyond copyright to restitutionary cases more generally.<sup>126</sup> Perhaps the best-known examples include *Olwell v. Nye & Nissen*<sup>127</sup> and *Edwards v. Lee's Administrator*.<sup>128</sup> In both cases, the property owners' legal damages were slight. In *Olwell*, the defendant converted Olwell's egg-washing machine, but the machine was in storage before the defendant's conscription, and it took Olwell some three years to notice that the machine was missing.<sup>129</sup> Moreover, the machine seemed to be no worse for wear.<sup>130</sup> In *Edwards v. Lee's Administrator*, the plaintiff's land included portions of an underground cave whose only entrance was on the defendant's property.<sup>131</sup> The defendant sold tours of the cave, including the portions located on plaintiff's land, but there was no dispute that the plaintiff could not have accessed or exploited the cave on his own.<sup>132</sup>

Both defendants sought to limit the plaintiffs' recovery to the rental value of the properties, but in both cases, the courts disgorged the defendants' profits made from use of the plaintiffs' properties.<sup>133</sup> The courts thought it unjust to allow the defendants to retain the

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124. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940) ("Prior to the Copyright Act of 1909, there had been no statutory provision for the recovery of profits, but that recovery had been allowed in equity both in copyright and patent cases as appropriate equitable relief incident to a decree for an injunction.").

125. 17 U.S.C. § 504; LAYCOCK, *supra* note 73, at 525.

126. *See generally* *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 345 (1st Cir. 1942) (noting that "accountability of an infringer for the profits he has made had its origin in equity").

127. *Olwell v. Nye & Nissen Co.*, 173 P.2d 652 (Wash. 1946).

128. *Edwards v. Lee's Adm'r*, 96 S.W.2d 1028 (Ky. 1936).

129. *Olwell*, 173 P.2d at 652–53.

130. *Id.* at 653–54.

131. *Edwards*, 96 S.W.2d at 1029.

132. *Id.* at 1030.

133. *Id.* at 1030, 1032; *Olwell*, 173 P.2d at 653–54.

profits acquired by wrongdoing.<sup>134</sup> As a result, even though the plaintiffs' use-value damages were slight, the measure of recovery was the defendants' gains rather than the plaintiffs' losses.<sup>135</sup>

Disgorgement cases outside of copyright, such as *Owll* and *Edwards*, may be useful in analyzing the proper method of allocating overhead for copyright infringement because "there is no basis to conclude that the measure of unjust enrichment for claims regarding patents, design patents, copyrights, trademarks and trade secrets were related to anything but traditional law for accounting in equity."<sup>136</sup> In order to determine whether to allow the deduction of overhead expenses from infringement revenues, we must determine the purpose behind the disgorgement remedy. Once we have identified the purpose or purposes of disgorgement as a remedy, we can consider whether and to what extent the allocation or non-allocation of overhead furthers that purpose in copyright infringement cases.

#### A. Utility and Deterrence

Some have argued that disgorgement serves a coercive purpose, acting as a deterrent to would-be infringers by depriving them of the fruits of infringement.<sup>137</sup> For example, in *Kamar International, Inc. v. Russ Berrie & Co.*,<sup>138</sup> the Ninth Circuit suggested that "[a]n award of infringer's profits is aimed in part at deterring infringements."<sup>139</sup> Disgorgement unquestionably has at least a moderate deterrent

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134. *Edwards*, 96 S.W.2d at 1032; *Owll*, 173 P.2d at 653 (discussing the wrongdoer's duty "to repay an unjust and unmerited enrichment").

135. *Owll*, 173 P.2d at 654; *Edwards*, 96 S.W.2d at 1032.

136. Roach, *supra* note 34, at 506; *see also* *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 346 (1st Cir. 1942) (when Congress statutorily authorized disgorgement, "there was no change in the principle upon which such relief had theretofore been granted by courts of equity").

137. *See, e.g.*, Kull, *supra* note 110, at 18–19 ("Both disgorgement and punitive damages are therefore justified by the need to create a stronger disincentive to wrongful conduct—conduct that the threat of liability for actual damages does not adequately deter.").

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

139. *Id.* The court stated that these dual goals could "best be achieved by allowing a deduction for overhead only when the infringer can demonstrate it was of actual assistance in the production, distribution or sale of the infringing product," although it did not explain how such deductions would further these purposes. *Id.*



effect in that it usually renders the wrongful act unprofitable to the defendant.<sup>140</sup>

Unsurprisingly, Judge Posner champions a deterrence-based view of disgorgement. He maintains that disgorgement promotes economic efficiency by deterring infringers from bypassing the market. He points out that plaintiffs seek disgorgement only when the infringer's profits exceed the plaintiff's provable losses—in other words, where the defendant puts the purloined property to a more efficient use than the plaintiff would have (or, at least, than the plaintiff can prove that he or she would have). Judge Posner notes that it may seem strange to “punish” the defendant for increased efficiency, but this “makes any would-be infringer negotiate directly with the owner of a copyright that he wants to use.”<sup>141</sup> Limiting damages to the copyright holder's loss would not adequately deter the “forced exchange” in which the infringer bypasses the market by stealing the copyright.<sup>142</sup>

The Third Restatement offers both deterrence (forward looking) and corrective-justice (backward looking) rationales for disgorgement.<sup>143</sup> Many cases follow suit, identifying mixed purposes for the disgorgement remedy.<sup>144</sup>

This identification of multiple purposes suggests that the courts and the Restatement's drafters recognize the inability of deterrence alone to fully account for disgorgement practices. If the purpose of disgorgement is to eliminate any incentive to infringe, then infringement must be rendered unprofitable.<sup>145</sup> The remedy must deter the wrongdoer's “opportunistic behavior by making it worthless

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140. *United States v. Rx Depot, Inc.*, 438 F.3d 1052, 1061 (10th Cir. 2006) (“Disgorgement, which deprives wrongdoers of their ill-gotten gains, deters violations of the law by making illegal activity unprofitable.”).

141. *Taylor v. Meirick*, 712 F.2d 1112, 1120 (7th Cir. 1983).

142. *Id.*

143. RESTATEMENT (THIRD), *supra* note 19, § 3 cmt. c (“Restitution requires full disgorgement of profit by a conscious wrongdoer, not just because of the moral judgment implicit in the rule of this section, but because any lesser liability would provide an inadequate incentive to lawful behavior.”). The majority of the Third Restatement's discussion of disgorgement focuses on the incentives of future potential wrongdoers. *See id.* ch. 7, intro. note (“Restitution by a profit measure (often called ‘disgorgement’) is normally directed at conscious wrongdoers—not against blameless tortfeasors whose conduct would not be affected by the prospect of liability measured by wrongful gain.”).

144. *See infra* Section III.D.

145. *Rx Depot*, 438 F.3d at 1058 & n.4.

to him, which can be done by making him hand over all his profits from the breach to the promisee.”<sup>146</sup> But if disgorgement’s coercive effect is the sole concern, there is no reason to limit the remedy to the amount of the defendant’s profits. Holding the infringer liable for any amount equal to or greater than the infringer’s profits would produce this effect. And, in fact, the infringer’s prospective liability must exceed its profits to adequately deter an infringer who thinks that its infringement might go undetected.<sup>147</sup> Thus, effective deterrence requires a remedy that exceeds the defendant’s profits by an amount proportional to future defendants’ perceptions of the likelihood of undetected infringement—we must make prospective infringement unprofitable *after* the defendant discounts the likely remedy by the odds of detection.<sup>148</sup> Therefore, disgorgement as it presently exists—limited to the infringer’s profits—does not effectively deter.

That said, perhaps there is a utilitarian argument for limiting the recovery to the defendant’s profits—greater recoveries may unacceptably increase the cost of production for accidental infringers. People who risk inadvertent infringement<sup>149</sup>—singers, writers, producers, authors, painters, and others—may fear extreme liability so greatly that they take excessive and inefficient precautions against infringement. For example, they might run excessive searches for anything that might be considered infringement. Or they might

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146. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 129 (9th ed. 2014).

147. With the remedy limited to the defendant’s profits, if the defendant gets away with the wrongdoing, it will be better off than it would have been acting legitimately, and, if it gets caught, it is in the same position as if it had acted legitimately. See Gergen, *supra* note 6, at 829 n.11. Gergen’s proffered explanation for the under-deterrence of disgorgement is that “what is permissible in the way of deterrence is constrained by what the instinct for retribution allows.” *Id.*

148. If the defendant expects to make \$100 from infringement and expects that there is a 50% chance of being held liable, then the defendant must face a threatened remedy of at least \$200 in order to be properly incentivized against the infringement. Any lesser amount renders the infringement prospectively profitable and would not deter a rational profit-maximizing defendant.

149. An example of inadvertent infringement is the idea of “subconscious copying,” in which a songwriter has heard a song and, in writing a later song, subconsciously includes portions of the prior song in his own song. Examples include George Harrison’s “My Sweet Lord” (which subconsciously copied The Chiffons’ “He’s So Fine”), and Michael Bolton’s “Love Is a Wonderful Thing” (which subconsciously copied the Isley Brothers’ “Love is a Wonderful Thing”). *Three Boys Music Corp. v. Bolton*, 212 F.3d 477, 482–84 (9th Cir. 2000). In addition, inadvertent infringement may arise when the infringer honestly but erroneously believes that its infringement falls within the fair use defense.

refrain from using portions of a copyrighted work even though such a use would constitute fair use. In other words, excessive liability risks inhibiting the constitutional goal of the promotion of “Science and the useful Arts.”<sup>150</sup> Consequently, limiting disgorgement to the infringer’s profits—that is, attempting to remove from the infringer all gains stemming from infringement, but going no farther than that—may be seen as a compromise that best balances the goal of deterring infringement with limiting search-cost and other inefficiencies.

### *B. Punishment*

Some have focused on the retributive interest as a basis for disgorgement.<sup>151</sup> The retributive interest and the coercive interest differ in that the retributive interest is backward-looking rather than forward-looking; it seeks punishment for previously-committed, morally culpable conduct. The coercive interest, on the other hand, is indifferent to the defendant’s previously-committed conduct, except insofar as disgorgement for past conduct will deter future wrongdoing.

The recent unanimous Supreme Court decision in *Kokesh v. SEC*<sup>152</sup> distinguished the “disgorgement” in SEC enforcement proceedings—which it held to be penal in nature—from traditional common-law disgorgement. In *Kokesh*, the applicability of the statute of limitations hinged on whether the liability imposed on the defendant amounted to a “penalty,” as that term was used in the statute.<sup>153</sup> Concluding that SEC disgorgement operated as a penalty, the Court took pains to note that its holding applied only to “disgorgement, *as applied in SEC enforcement actions.*”<sup>154</sup> Indeed, the Court’s analysis focused on several

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150. U.S. CONST. art. I, § 8, cl. 8.

151. *E.g.*, Tricia Bozyk, *Disgorging American Business: An Examination of Overbroad Remedies in Civil RICO Cases*, 59 RUTGERS L. REV. 129, 140 (2006) (“Disgorgement can be construed as punitive in nature rather than a method of restitution.”).

152. *Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

153. *Id.* at 1639–40. The courts below had held that the SEC’s recovery was “disgorgement” rather than a “penalty,” so that the limitations statute did not apply. *Id.* at 1641.

154. *Id.* at 1642 n.3 (emphasis added); *see also id.* (noting that the Court’s opinion “should be interpreted as an opinion on . . . whether courts have properly applied disgorgement principles in this context”). The Court was careful throughout its opinion to refer to the remedy in this type of case as “SEC disgorgement” rather than merely as “disgorgement.”

related characteristics present in SEC “disgorgement” orders not found in traditional disgorgement.

First, the SEC penalties were imposed for offenses committed against the state, rather than against private parties.<sup>155</sup> If the action had been “a compensatory remedy for a private wrong,” such as a violation of the rights of the plaintiff, it would not be penal.<sup>156</sup> Second, SEC disgorgement penalties are paid to the court, and the court has discretion to determine how to distribute the funds.<sup>157</sup> In other words, the money does not necessarily find its way to the victim of the wrongdoing—some disgorged funds “are dispersed to the United States Treasury.”<sup>158</sup> Traditional disgorgement, by contrast, is “paid entirely to a private plaintiff.”<sup>159</sup> Finally, lower courts had emphasized the “primary purpose” of the penalty was deterrence.<sup>160</sup> Because the disgorgements were government-initiated, and were therefore public-law-based rather than private-law-based, their use as a deterrent could only be described as penal, because “deterrence [is] not [a] legitimate nonpunitive governmental objectiv[e].”<sup>161</sup>

The Court rejected the government’s argument that the SEC disgorgement was remedial rather than punitive because it sought only to restore the status quo ante.<sup>162</sup> In SEC enforcement actions, defendants are sometimes required to “disgorge” gains made by other people,<sup>163</sup> as *Kokesh* was.<sup>164</sup> Such disgorgement does not restore the status quo because the defendant must pay money in excess of his wrongful receipts.<sup>165</sup> And “SEC disgorgement sometimes is ordered without consideration of a defendant’s expenses that reduced the amount of illegal profit,”<sup>166</sup>—a result that “does not simply restore the

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155. *Id.* at 1643.

156. *Id.* at 1642. The Court’s example was a claim for statutory damages for copyright infringement. *Id.*

157. *Id.* at 1644.

158. *Id.*

159. *See id.* at 1643.

160. *Id.* at 1643–44.

161. *Id.* (quoting *Bell v. Wolfish*, 441 U.S. 520, 539 n.20 (1979) (alterations in original)).

162. *Id.* at 1644.

163. *Id.*

164. *SEC v. Kokesh*, 834 F.3d 1158, 1164–65 (10th Cir. 2016), *rev’d*, 137 S. Ct. 1635 (2017).

165. *Id.*

166. *Kokesh*, 137 S. Ct. at 1644–45.

status quo; it leaves the defendant worse off.”<sup>167</sup> In contrast to traditional disgorgements, SEC disgorgements “go beyond compensation, are intended to punish, and label defendants wrongdoers’ as a consequence of violating public laws.” They consequently constitute a “penalty” within the meaning of the statute.<sup>168</sup>

Professor Kull notes that the “salient feature of most restitution for wrongs—the fact that the remedy gives the plaintiff more than he lost—seems to point toward a punitive rationale.”<sup>169</sup> But he also observes that punishment is an unlikely candidate to explain traditional disgorgement,<sup>170</sup> given that disgorgement is limited to the infringer’s profits and does not depend on the defendant’s wealth or business success in general.<sup>171</sup> If punishment were our primary concern, then there would seem to be little reason to permit the defendant to deduct even variable expenses from the profits, as the Court noted in *Kokesh*,<sup>172</sup> or, for that matter, to tie the award to the defendant’s profits at all.<sup>173</sup> In other words, there would be little reason to distinguish disgorgement from punitive damages more generally and no obvious reason to prefer disgorgement over a traditional form of punitive damages.<sup>174</sup> Moreover, existing copyright law permits disgorgement of the profits of even innocent infringers,<sup>175</sup> whereas, under a punishment theory, disgorgement should be limited

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167. *Id.* at 1645.

168. *Id.* (quoting *Gabelli v. SEC*, 568 U.S. 442, 451–52 (2013)).

169. Kull, *supra* note 110, at 18.

170. *See id.*; *see also* *Christensen v. Nat’l Brake & Elec. Co.*, 10 F.2d 856, 862 (E.D. Wis. 1924) (“It was not and is not intended . . . that the principles of stating the account . . . should be applied to produce purely punitive results.”) (patent infringement); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (“Disgorgement is remedial and not punitive.”).

171. *City of Elizabeth v. Am. Nicholson Pavement Co.*, 97 U.S. 126, 139 (1878) (“[T]hough the defendant’s general business be ever so profitable, if the use of the invention has not contributed to the profits, none can be recovered. . . . [A] court of equity cannot give a decree for profits . . . as a punishment for the infringement.”).

172. *Kokesh*, 137 S. Ct. at 1644–45.

173. WEINRIB, *supra* note 105, at 141 (“No attempt is made to calibrate the unrecouped costs to the trespasser’s desert. From a punitive standpoint, this is odd, since the amount of the supposed punishment is not necessarily related to the trespasser’s culpability.”).

174. RESTATEMENT (THIRD), *supra* note 19, § 51 cmt. k (noting that exemplary damages may be needed to supplement disgorgement, since disgorgement “imposes no net loss on the defendant,” and that the “rationale of punitive or exemplary damages is independent of the law of unjust enrichment”).

175. *See Ciolino*, *supra* note 4, at 30.

to cases of a sufficiently culpable *mens rea*.<sup>176</sup> In addition, the Copyright Act already creates criminal liability for willful copyright infringement,<sup>177</sup> and criminal punishment serves the retributive interest (or, depending on one's jurisprudence, the coercive interest).<sup>178</sup> Consequently, disgorgement, if punitive or deterrent, risks overpunishing or overdetering because it coexists with criminal penalties already designed to adequately punish or deter. Presumably for these reasons, courts and scholars,<sup>179</sup> as well as the Third Restatement,<sup>180</sup> object to a punitive justification of disgorgement.

### C. Corrective Justice

For the reasons discussed above, a punishment rationale offers the least promising explanation of disgorgement.<sup>181</sup> A deterrence rationale, though more promising, still does not fully address the current practices surrounding disgorgement, including its limitation to the profits of the wrongdoer (rather than being adjusted by an odds-of-detection multiplier) and its application to inadvertent and even no-fault infringement.<sup>182</sup> A better candidate for explaining the current practice is corrective justice. Corrective justice suggests “that wrongful gains and losses are to be annulled,”<sup>183</sup> and it is sometimes

176. This is true for a deterrence theory as well, although the particular *mens rea* may differ between punishment theories and deterrence theories.

177. 17 U.S.C. § 506 (2012). In addition, some courts have questioned the traditional belief that punitive damages are not available outside of statutory damages in copyright. *See, e.g.*, *Blanch v. Koons*, 329 F. Supp. 2d 568 (S.D.N.Y. 2004). The weight of authority, however, rejects punitive damages. *See* 2 HOWARD B. ABRAMS, *THE LAW OF COPYRIGHT* § 17:22 (2003).

178. *See* John Finnis, *Natural Law: The Classical Tradition*, in *THE OXFORD HANDBOOK OF JURISPRUDENCE AND PHILOSOPHY OF LAW* 1, 49–50 (Jules L. Coleman et al. eds., 2004).

179. *See supra* notes 169–71.

180. RESTATEMENT (THIRD), *supra* note 19, § 51 cmt. h (“Denial of an otherwise appropriate deduction, by making the defendant liable in excess of net gains, results in a punitive sanction that the law of restitution normally attempts to avoid.”); *id.* § 51 cmt. k (“Disgorgement of wrongful gain is not a punitive remedy. While the remedy will be burdensome to the defendant in practice . . . the wrongdoer who is deprived of an illicit gain is ideally left in the position he would have occupied had there been no misconduct.”).

181. *See supra* notes 169–78.

182. *See supra* notes 145–47 and accompanying text.

183. Jules Coleman, *Corrective Justice and Wrongful Gain*, 11 J. LEGAL STUD. 421, 432 (1982) [hereinafter Coleman, *Corrective Justice and Wrongful Gain*]; *see also* JULES COLEMAN, *RISKS AND WRONGS* 369 (reprint 2003) (1992) [hereinafter COLEMAN, *RISKS AND WRONGS*]. The question of whether corrective justice necessarily entails a duty on the part of a particular

described as “the relational structure of reasoning in private law.”<sup>184</sup> To annul wrongful gains and losses, we look to the “rightful position” of the parties.

The “rightful position” inquiry is commonly undertaken in assessing a plaintiff’s wrongful losses.<sup>185</sup> This is because, in the run of tort cases, defendants do not profit financially from their wrongdoing, so most inquiries focus on restoring the wronged plaintiffs to their rightful positions.<sup>186</sup> The defendant’s harm of the plaintiff “upsets the equilibrium that existed between the parties” prior to the harm,<sup>187</sup> and the plaintiff is entitled to be restored to its pre-tort position, even if doing so results in the defendant being made worse off relative to its pre-tort position.<sup>188</sup> (Some corrective-justice theorists, such as Professor Weinrib, reject the idea that the plaintiff’s wrongful loss could exceed the defendant’s gain, instead positing that the plaintiff’s loss and the defendant’s gain are always equal.<sup>189</sup>)

In disgorgement cases, on the other hand, defendants have profited sufficiently from their invasions of the plaintiffs’ rights that they could put the plaintiffs in their but-for-the-wrong factual positions (arguably their rightful positions) and still remain better off

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person to pay for the wrongful losses or a claim on the part of a particular person to recover wrongful gains is taken up later. See *infra* Section IV.C.4.

184. WEINRIB, *supra* note 105, at 2.

185. See LAYCOCK, *supra* note 73, at 13.

186. Coleman, *Corrective Justice and Wrongful Gain*, *supra* note 183, at 424–26.

187. Jules L. Coleman, *Property, Wrongfulness and the Duty to Compensate*, 63 CHI.-KENT L. REV. 451, 454 (1987) [hereinafter Coleman, *Property*]; see Richard A. Epstein, *Privacy, Publication, and the First Amendment: The Dangers of First Amendment Exceptionalism*, 52 STAN. L. REV. 1003, 1012 (2000). Coleman’s early view of corrective justice stopped here. He rejected the idea that corrective justice requires the wrongdoer to compensate the plaintiff, concluding instead that it only requires the plaintiff to be compensated. See Coleman, *Property*, *supra*, at 461–62.

188. Under the most common view of corrective justice, the defendant’s causation of the plaintiff’s loss triggers the defendant’s obligation to rectify that loss. See COLEMAN, RISKS AND WRONGS, *supra* note 183, at 320–24.

189. See Ernest J. Weinrib, *Causation and Wrongdoing*, 63 CHI.-KENT L. REV. 407, 437–38 (1987); see also Matthew H. Kramer, *Of Aristotle and Ice Cream Cones: Reflections on Jules Coleman’s Theory of Corrective Justice*, 16 QLR 279, 285–93 (1996). But see *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 345 (1st Cir. 1942) (“The profits which were made by the infringer may bear no relation to the damages suffered by the copyright proprietor.”); CHARLIE WEBB, REASON AND RESTITUTION: A THEORY OF UNJUST ENRICHMENT 236–38 (2016) (countering Weinrib’s reading of Aristotle). See generally Lionel D. Smith, *Disgorgement of the Profits of Breach of Contract: Property, Contract and “Efficient Breach,”* 24 CANADIAN BUS. L.J. 121, 122 (1994) (asserting that, in disgorgement, “loss suffered by the plaintiff is irrelevant”).

than the defendants would have been in the absence of the wrongdoing.<sup>190</sup> The corrective-justice account recognizes that such gains are “wrongful” and that they occurred at the plaintiffs’ expense.<sup>191</sup> Consequently, corrective justice demands that the defendants disgorge their ill-gotten gains received through violation of the plaintiff’s property rights.<sup>192</sup> In other words, corrective justice seeks to annul both the plaintiff’s wrongful loss and the defendant’s wrongful gain.<sup>193</sup>

Most explanations of disgorgement explicitly speak the moral language of corrective justice,<sup>194</sup> replete with references to “desert,”<sup>195</sup> “justice,”<sup>196</sup> “fairness,”<sup>197</sup> and “unconscionability.”<sup>198</sup> These explanations speak of what “rightfully” belongs to the plaintiff and the

190. Some corrective-justice theorists insist that defendants’ gains and plaintiffs’ losses always correspond. *See, e.g.*, Kramer, *supra* note 189, at 293.

191. COLEMAN, RISKS AND WRONGS, *supra* note 183, at 371 (referring to “restitutionary justice”); Kramer, *supra* note 189, at 284.

192. WEINRIB, *supra* note 105, at 127 (“If [plaintiff’s] rights include the possibility of gain, then the defendant’s gain measures the extent of the plaintiff’s injury.”).

193. Coleman, *Property*, *supra* note 187, at 463.

194. SEC v. Thomas James Assocs., Inc., 738 F. Supp. 88, 93 (W.D.N.Y. 1990) (“The primary purpose of this disgorgement is also well established: [It] is not to compensate [plaintiffs, but] it is a method of forcing a defendant to give up the amount by which he was unjustly enriched.”); Kull, *supra* note 110, at 19 (“[T]here is no need to refer to punishment objectives to explain what restitution is doing. Restitution’s starting objective is . . . to strip the defendant of a wrongful gain.”).

195. *Livingston v. Woodworth*, 56 U.S. (15 How.) 546, 560 (1853) (stating, in a patent disgorgement case, that plaintiffs “will be allowed to claim that which, *ex aequo et bono*, is theirs, and nothing beyond this”); WEINRIB, *supra* note 105, at 117 (“Many of the current treatments of gain-based damages for torts focus on the defendant’s desert . . .”).

196. *See, e.g.*, *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940) (disgorgement is “given in accordance with the principles governing equity jurisdiction, not to inflict punishment but to prevent an unjust enrichment”); *Tilghman v. Proctor*, 125 U.S. 136, 145–46 (1888); *Moses v. MacFerlan* (1760) 97 Eng. Rep. 676, 681 (K.B.) (“In one word, the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money.”).

197. *In re Indep. Serv. Orgs. Antitrust Litig.*, 23 F. Supp. 2d 1242, 1250 (D. Kan. 1998) (“The purpose of awarding both actual damages and profits is ‘to prevent the infringer from unfairly benefiting from a wrongful act.’” (quoting 4 NIMMER & NIMMER, *supra* note 6, § 14.03)).

198. *Sammons v. Colonial Press, Inc.*, 126 F.2d 341, 345 (1st Cir. 1942) (“The theory was that it was unconscionable for an infringer to retain a benefit which he had received by the appropriation and use of the plaintiff’s property right . . .”).



defendant,<sup>199</sup> and they assert that disgorgement seeks to deprive the defendant of “wrongful” gains without imposing a penalty on the wrongdoer. That is, disgorgement should deprive the defendant of any advantage it gained by infringement, but it should take no more than necessary to accomplish this purpose.<sup>200</sup> In an early patent case (before the Patent Act eliminated disgorgement as a patent infringement remedy), the Supreme Court emphasized this purpose of disgorgement:

The reasons that have led to the adoption of [disgorgement] are, that it comes nearer than any other to doing complete justice between the parties; that in equity the profits made by the infringer of a patent belong to the patentee and not to the infringer; and that it is inconsistent with the ordinary principles and practice of courts of chancery, either, on the one hand, to permit the wrongdoer to profit by his own wrong, or, on the other hand, to make no allowance for the cost and expense of conducting his business, or to undertake to punish him by obliging him to pay more than a fair compensation to the person wronged.<sup>201</sup>

Gain-based damages under a corrective-justice account seek to undo the benefits to the defendant that flowed from his implicit assertion of ownership in the plaintiff’s property,<sup>202</sup> or stated differently, to “reverse the wrong by showing, through the return of the benefits, that the law considers the defendant’s implicit assertion of ownership to be a nullity whose consequences are to be undone.”<sup>203</sup>

#### *D. Mixed Purposes*

Corrective justice holds the most promise for offering an internally coherent explanation of disgorgement. But many have suggested that

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199. The remedy is designed to achieve “a rational separation of the net profits so that neither party may have what rightfully belongs to the other.” *Sheldon*, 309 U.S. at 404 (quoting *Dowagiac Mfg. Co. v. Minn. Moline Plow Co.*, 235 U.S. 641, 647 (1915)); *Livingston*, 56 U.S. (15 How.) at 560 (in a patent disgorgement case, reversing a judgment for what the defendants *could have* made, if they’d exercised diligence, and stating that plaintiffs “will be allowed to claim that which, *ex aequo et bono*, is theirs, and nothing beyond this”).

200. *See, e.g.*, sources cited *supra* note 199; *see also* *Levin Bros. v. Davis Mfg. Co.*, 72 F.2d 163, 165 (8th Cir. 1934).

201. *Tilghman*, 125 U.S. at 145–46 (1888).

202. WEINRIB, *supra* note 105, at 126.

203. *Id.*

disgorgement simultaneously serves both deterrence and corrective justice. This view has been expressed by many courts and commentators,<sup>204</sup> and it makes an appearance in the Third Restatement as well.<sup>205</sup> In most cases, the deterrence rationale, which seeks to fashion incentives for bilateral negotiation rather than unilateral expropriation, results in remedies consistent with the corrective-justice rationale such that “there is little conflict between these goals.”<sup>206</sup>

#### V. ALLOCATING OVERHEAD TOWARD THE PROFITS OF INFRINGEMENT

As discussed above, restitution scholars have proposed several distinct purposes in which to ground the remedy of disgorgement. Any view of the proper way to allocate overhead must be informed by the purposes to which the underlying disgorgement remedy is directed. The following sections assess the propriety of overhead allocation in light of the various purposes identified for disgorgement: deterrence, retribution, and corrective justice. I argue that both the deterrence view and the corrective-justice view (and, perhaps, the retributive view) suggest that an infringing defendant should be permitted to allocate overhead only when it can prove that, in the absence of infringement, it would have used the overhead to create additional noninfringing products.

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204. *See, e.g.*, *Rubber Co. v. Goodyear*, 76 U.S. (9 Wall.) 788, 804 (1869) (“The rule is founded in reason and justice. It compensates one party and punishes the other.”) (patent case); *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1115 (9th Cir. 2006) (suggesting that disgorgement serves both a “deterrent purpose . . . [and] the goal of depriving a wrongdoer of unjust enrichment”); *Dad’s Root Beer Co. v. Doc’s Beverages, Inc.*, 94 F. Supp. 121, 122 (S.D.N.Y. 1950) (“Upon the facts, it would be unconscionable to permit defendants to retain any reward from their illegal enterprise. Nor should the law be such as to offer the slightest encouragement to those who perpetrate the kind of acts herein condemned.”); *WEBB*, *supra* note 189, at 188 (discussing “the good of ensuring wrongdoers don’t profit from their wrongs and/or deterring others who would seek to do the same”).

205. RESTATEMENT (THIRD), *supra* note 19, § 3 (“Restitution requires full disgorgement of profit by a conscious wrongdoer, not just because of the moral judgment implicit in the rule of this section, but because any lesser liability would provide an inadequate incentive to lawful behavior.”).

206. *Roach*, *supra* note 34, at 526 (“The case law . . . involves two inter-related goals: disgorging the defendant’s benefits and denying the defendant any economic incentive to infringe. Generally there is little conflict between these goals[,] . . . [and] there is little guidance in case law or law journal articles about the relative priority of either goal.”).

*A. The Coercive View of Overhead Allocation*

Under the coercive view of disgorgement, the purpose of disgorgement is to create appropriate incentives for potential infringers to utilize the market to obtain property rights rather than expropriating those rights to themselves. This coercive view suggests that disgorgement is an improper remedy in cases of inadvertent infringement, such as subconscious copying. And as discussed in section III.A, the risk of disgorgement may prompt excess precautions on the part of those who risk inadvertent infringement.<sup>207</sup>

One solution to the risk of excessive precautions is to distinguish between conscious and inadvertent wrongdoers, as is done in other disgorgement contexts. This distinction was central to the development of disgorgement law in equity—disgorgement of a wrongdoer’s profits was, in many cases, available only against conscious wrongdoers.<sup>208</sup> This possible solution, however, has not been applied in the copyright context—disgorgement is a remedy available to all copyright plaintiffs, even in cases of inadvertent infringement.<sup>209</sup>

But, even in copyright law, this culpability distinction could impact the way profits are measured—profits could be measured more stringently against willful infringers to ensure that they are not made better off by their infringement. This is the position of those who argue for a distinction between willful and nonwillful infringers when it comes to overhead allocation. They fear that willful or reckless infringement would be insufficiently deterred if infringers were permitted to allocate overhead toward the infringing products, thereby subsidizing their legitimate business through their infringing conduct.<sup>210</sup> Thus, one commentator worried about the “paradox” created when individuals advocate the allocation of overhead while simultaneously arguing for “the goal of denying any incentive to the infringer.”<sup>211</sup> Allocating overhead toward infringing profits leaves the

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207. See *supra* notes 148–49 and accompanying text.

208. LAYCOCK, *supra* note 73, at 525. One prominent exception was trust law. In trust law, a fiduciary’s breach of trust was subject to disgorgement even if it was inadvertent. See *supra* Part II.

209. LAYCOCK, *supra* note 73, at 525.

210. See *generally* *Hamil Am., Inc. v. GFI*, 193 F.3d 92, 106–07 (2d Cir. 1999) (discussing the subsidization concern).

211. Roach, *supra* note 34, at 487.

infringer better off—even after the disgorgement—than it would have been in the absence of infringement.

Consider this subsidization-by-infringement concern as illustrated in a practical example. Suppose that a book publisher publishes ninety-nine legitimate books in a given year, costing \$495,000 in variable expenses and generating revenues of \$1 million. The publisher's overhead is \$100,000, which includes things such as salaried employees, depreciation of the equipment, and the lease of real property. The printer and other publishing equipment is in use only a fraction of its available time but otherwise sits idly the rest of the time. Now suppose that the publisher decides to publish an infringing book, and the book costs \$5000 in variable expenses and generates gross revenues of \$10,000. The profits from the book will be either \$5000 or \$4000, depending on whether the defendant allocates a portion of its overhead to the infringing book.<sup>212</sup> It is clear that the infringing book did not contribute to the overhead, although it is equally clear that the book could not have been published—and the profits could not have been made—without at least some of the overhead expenditures. If our goal is to take away from the wrongdoer all profits resulting from the wrongdoing, we should not permit the wrongdoer a credit for the overhead against the profits from the pirated book.<sup>213</sup> In the absence of infringement, the defendant would have made a profit of \$405,000 that year.<sup>214</sup> If we permit the defendant to allocate \$1000 of overhead to the infringing book, the defendant's profit increases to \$406,000.<sup>215</sup> In other words, if the defendant can allocate overhead toward the infringing book, the defendant is made better off as a result of infringement, and the noninfringement incentives are suboptimal.

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212. There are multiple ways to allocate overhead. See 4 NIMMER & NIMMER, *supra* note 6, § 14.03. In this example, I employ the fractional share of the infringing product to all products to allocate overhead (1/100, or 1%), resulting in an allocation of \$1000.

213. If the publisher is an individual, he will not be able to charge his hours worked on the article. This is part of the bought-and-paid-for rule, which says that profits are reduced only by inputs that the defendant paid for. See *Kamar Int'l, Inc. v. Russ Berrie & Co.*, 752 F.2d 1326, 1331 (9th Cir. 1984). For employees, hourly wages would be a variable expense, while salaried employees would be fixed. (Nevertheless, some hourly wage-earners, such as receptionists, may fall under "overhead.")

214. \$1 million (gross revenues) - \$495,000 (variable expenses) - \$100,000 (overhead).

215. \$1,010,000 (gross revenues) - \$4000 (profits from infringement) - \$500,000 (variable expenses) - \$100,000 (overhead).

Even in cases of willful infringement, however, the subsidization concern matters only if the infringer would not have produced some other additional product in the absence of infringement.<sup>216</sup> If, on the other hand, the defendant would have produced additional noninfringing products, then the infringement does not leave the defendant better off than the position it would have occupied in the absence of infringement. In such a case, we can allocate overhead in determining the infringer's profits without the concern that the infringer will have the incentive to subsidize its lawful production with infringing production.

Suppose that, in the above example, the defendant can show that had it not published the infringing book, it would have published another book. The \$1000 of overhead that contributed to publishing the infringing book instead would have been allocated to the noninfringing book. In that case, allowing overhead allocation does not render the defendant financially better off as a result of the infringement. In other words, if the defendant can show an opportunity cost of infringement<sup>217</sup>—a lost opportunity that resulted from its production of the infringing product—proportional overhead may be allocated to the infringing product without creating infringement-subsidization concerns. Likewise, if the defendant can show that it incurred a particular overhead expense because of the infringement, that overhead should be deducted from the award.<sup>218</sup>

Thus, under a deterrence-based view of disgorgement, the propriety of overhead allocation turns on what the defendant would have done had it not infringed. We must play out the counterfactual in which the defendant did not engage in the infringement and then

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216. Margolis, *supra* note 48, at 1560 (recognizing that overhead should not be allocated in “instances in which excess capacity can be established”).

217. *Id.* at 1545.

218. Perhaps the starkest example would be an infringer who starts a business for the sole purpose of infringing. If the infringer makes only one product—the infringing product—then all of the infringer's overhead should be allocated against the gross receipts from the infringing product. This measure is relatively uncontroversial; as Professor Laycock has said, “[A]t some point, the growth of the infringing part of the business will force an increase in overhead, and everyone agrees the court should take account of that.” LAYCOCK, *supra* note 73, at 538; *see also* Roach, *supra* note 34, at 497 (“There have been at least two cases in which the defendant's entire operation infringed . . . . The court in both cases approved offset credit for fixed costs and other expenses that would not normally be offset except when all of the defendant's operations infringe.”).

determine whether the defendant would have produced additional noninfringing products but for the infringement. The objective of the counterfactual would be to determine whether, without the wrong, the defendant's overhead would have been spread among its existing noninfringing production, or whether the defendant would have spread the overhead among additional products.<sup>219</sup> In awarding disgorgement after conducting this analysis, we do not risk underdeterrence of the willful infringer, and there is no reason to assume that this approach would overdeter the productivity of those who risk inadvertent infringement.

### *B. The Punitive View of Overhead Allocation*

If the sole purpose of disgorgement is to punish the wrongdoer (a purely retributive purpose and not an exemplary purpose designed to make an example out of the defendant to deter future wrongdoers), then there is no obvious reason to limit disgorgement to the wrongdoer's profits. One wrongdoer may have little or no profits from willful infringement, whereas another equally culpable wrongdoer may have substantial profits from willful infringement. Assuming that the wrongdoers have a claim-right to the profits from the infringement (a dubious but necessary assumption since a punitive purpose would be furthered only if disgorgement takes away something that rightfully belongs to the wrongdoer), then one wrongdoer is punished far less than an equally culpable, though less successful, wrongdoer.<sup>220</sup>

But to the extent that the punishment goal can correspond to a quantifiable measurement, the profits from infringement provide a measurable limit to the punitive nature of the infringement, thus providing a specific punitive measure to avoid the arbitrariness that is sometimes claimed to exist in unbounded, punitive tort awards.<sup>221</sup> Thus, Professor Weinrib has noted that "gain-based damages have been recommended as a way of introducing greater specificity into the punitive idea."<sup>222</sup> Disgorgement, it has been argued, "avoids the principal defect of punitive damages, which is the randomness in the

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219. Roach, *supra* note 22, at 1301–02.

220. Perhaps this is akin to punishing attempted crimes less severely than completed crimes. See Judith Jarvis Thomson, *The Decline of Cause*, 76 *Geo. L.J.* 137, 139–40 (1987).

221. See *Exxon Shipping Co. v. Baker*, 554 U.S. 471, 499 (2008).

222. WEINRIB, *supra* note 105, at 145 & n.48 (collecting sources).

amount of punitive awards.”<sup>223</sup> If the purpose of disgorgement is to punish for wrongdoing, any adequate punishment should deprive the wrongdoer—at least a conscious wrongdoer—of all gains from the wrongdoing, including consequential gains.

### *C. The Corrective-Justice View of Overhead Allocation*

#### *1. Calculation of profits*

The corrective-justice view of disgorgement suggests that defendants should be made to disgorge any wrongful gains incurred through infringement. To understand how to calculate the wrongful gains of the defendant, it is helpful to examine the obverse situation—the calculation of a tort-plaintiff’s wrongful losses.<sup>224</sup> In calculating a plaintiff’s rightful position in tort, we typically seek to determine the hypothetical outcome of the counterfactual in which the plaintiff never experienced the wrongful loss.<sup>225</sup> In other words, we ask: “Where would the plaintiff be but for the defendant’s wrongdoing?” The answer includes not only the plaintiff’s direct damages—property damage or bodily injury, for example—but it also includes any consequential losses flowing indirectly from the harm to the plaintiff,<sup>226</sup> such as when bodily injury prevents a plaintiff from resuming her former occupation.

The defendant’s rightful position in a disgorgement analysis should be subject to a similar analysis, taking into account both direct gains and consequential gains.<sup>227</sup> Under this analysis, the question of whether to allocate overhead against the revenues of infringement turns on the defendant’s behavior in the counterfactual universe: we ask whether the defendant’s overhead would have been spread among additional products in the absence of infringement, as discussed above

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223. Gergen, *supra* note 6, at 830.

224. For another work that compares wrongful losses in tort with wrongful gains in unjust enrichment, see WEBB, *supra* note 189, at 64–65.

225. LAYCOCK, *supra* note 73, at 13.

226. See Mark P. Gergen, *Restitution as a Bridge over Troubled Contractual Waters*, 71 *FORDHAM L. REV.* 709, 724 (2002) (discussing consequential damages and rightful position in contract); Baruch Lev & Meiring de Villiers, *Stock Price Crashes and 10b-5 Damages: A Legal, Economic, and Policy Analysis*, 47 *STAN. L. REV.* 7, 27 (1994).

227. See LAYCOCK, *supra* note 73, at 513.

with respect to the coercive view.<sup>228</sup> The Sixth Circuit adroitly phrased it this way:

The ideal approach to resolving the conflicting considerations present here would be to ascertain whether without the infringement the defendant could have employed the facilities which were devoted to the infringing production in a manner which would have covered the fixed costs at issue. If no alternative use were available, the fixed costs sought to be allocated against the profits from the infringement would have been borne by the defendant's existing non-infringing production, and a recovery of those costs would in effect reduce the cost of his other production, resulting in a net gain from the infringement.<sup>229</sup>

If corrective justice is the basis of disgorgement, the goal will be to divest the wrongdoer of its "ill-gotten gains" without taking more than necessary to accomplish this purpose. If more than the wrongful gain is disgorged from the defendant, the wrongdoer would be punished (not the goal of corrective justice) and, if that money were given to the plaintiff, the plaintiff would receive an unjust windfall (also contrary to the aims of corrective justice).

Because corrective justice seeks to divest the defendant of any gains resulting from infringement without imposing an additional penalty, the measure of disgorgement—and correspondingly, the method of allocating overhead—does not turn on the defendant's culpability in infringement. Why, then, have several courts focused on the infringer's willfulness in determining whether to allocate overhead? The confusion likely stems, in part, from the historical emphasis on the wrongdoer's willfulness *vel non* in restitution more generally.<sup>230</sup>

The confusion also may be related to a likely correlation between the proper analysis and the willfulness analysis. Under the proper analysis, the infringer should be permitted to allocate overhead in some, but not all, cases (specifically, in those in which it can prove that it would have created a substitute noninfringing product in the

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228. See *supra* Section IV.A.

229. Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166, 1172 (6th Cir. 1980). One slight quibble with the Sixth Circuit's suggested approach is that, instead of asking whether the defendant *could have* found additional revenue-generating uses for the fixed costs, the better question is whether the defendant *would have* found such uses.

230. See LAYCOCK, *supra* note 73, at 525.



absence of infringement). A willfulness focus would likewise suggest that the infringer should be permitted to allocate overhead in some, but not all, cases (specifically, those in which the infringement was willful).<sup>231</sup> And there may even be a general correlation between the two. It is reasonable to suspect that most willful infringers lack a profitable alternative product because, in most cases, infringers probably would not choose infringement if they had a profitable alternative.<sup>232</sup> Inadvertent infringement, on the other hand, does not itself suggest that the infringer lacked potentially profitable alternative products. But willfulness is the wrong focus when it comes to overhead allocation. Instead, the proper focus is the defendant's hypothetical position in the counterfactual in which the defendant did not infringe.

## 2. *Burdens of proof*

Although the Sixth Circuit recognized that the noninfringement counterfactual would be the “ideal approach,” the court rejected it as impractical, noting that “it will be difficult for the parties to show and the judge to determine what might have been.”<sup>233</sup> It is true that the defendant cannot prove with absolute certainty what would have happened in the absence of infringement. But we regularly ask plaintiffs to prove to the factfinder “what might have been” in tort cases in which the plaintiff seeks to recover consequential losses, such as lost profits. In those cases, the plaintiff is tasked with proving the counterfactual universe to a “reasonable certainty.”<sup>234</sup> It does not seem a monumental hurdle to task the defendant with convincing the factfinder that, but for the infringement, it would have used its overhead resources in some other revenue-generating fashion.<sup>235</sup>

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231. See *Saxon v. Blann*, 968 F.2d 676, 681 (8th Cir. 1992).

232. See *Gergen*, *supra* note 6, at 847 (the thief's “opportunity costs can be disregarded because we expect . . . people who turn to thievery do not have legitimate opportunities to make money”).

233. *Schmadig*, 620 F.2d at 1172; see also RESTATEMENT (THIRD), *supra* note 19, § 51 cmt. i (“The unusual difficulty of measurement in particular contexts explains why, in applying the disgorgement remedy, courts so often refer to burdens of proof and presumptions.”).

234. See, e.g., *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264–65 (1946); *Palmer v. Connecticut Ry. & Lighting Co.*, 311 U.S. 544, 565 (1941) (Douglas, J., dissenting); *Triple R Indus., Inc. v. Century Lubricating Oils, Inc.*, 912 F.2d 234, 237–38 (8th Cir. 1990).

235. “[T]he defendant bears the burden of establishing the appropriate deductions from gross revenues to calculate net profits,” as well as demonstrating the portion of profits

This is consistent with the current general practice in copyright disgorgement cases, which places the burden of proof with respect to offsets against the gross revenues on the defendant.<sup>236</sup> In a disgorgement case, the plaintiff must prove the gross revenues of infringement and the defendant must prove its allocation of expenses—that is, which costs (variable and fixed) should factor into the calculations. The defendant must also demonstrate a proper apportionment of profits by proving which profits, if any, are attributable to other inputs besides the infringement.<sup>237</sup> This is the traditional breakdown for the burden of proof in disgorgement cases generally,<sup>238</sup> and in the copyright context, the Copyright Act statutorily prescribes the burdens in this manner.<sup>239</sup> Exactitude is not required,<sup>240</sup> and the jury's fact-finding regarding the counterfactual should be treated with deference.<sup>241</sup>

In applying the general methodology to overhead allocation, then, there would be a presumption that the defendant would not have engaged in any other profitable activity in the counterfactual and, correspondingly, a presumption that overhead should not be allocated to the infringing product.<sup>242</sup> The burden of proof with respect to

attributable to inputs “other than the defendant’s wrongdoing.” RESTATEMENT (THIRD), *supra* note 19, § 42 cmt. h.

236. *Sullivan & Assocs., LLC v. Holladay*, No. 3:09CV00079 JLH, 2010 WL 2605730, at \*4 (E.D. Ark. June 25, 2010); *Roach*, *supra* note 34, at 516–17; *Rounds*, *supra* note 116, at 349.

237. 4 NIMMER & NIMMER, *supra* note 6, § 14.03[D].

238. RESTATEMENT (THIRD), *supra* note 19, § 51 cmt. i (describing this allocation of the burden of proof as the “traditional formula, inherited from trust accounting and enshrined in the Copyright Act”).

239. 17 U.S.C. § 504(b) (2012).

240. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 408 (1940) (“[W]hat is required is not mathematical exactness but only a reasonable approximation.”); *see also* *In Design v. K-Mart Apparel Corp.*, 13 F.3d 559, 564 (2d Cir.1994), *overruled on other grounds by* *Fears v. Wilhelmina Model Agency, Inc.*, 315 Fed. App’x. 333 (2d Cir. 2009).

241. *See Pro Football, Inc. v. Harjo*, 565 F.3d 880, 885 (2009) (noting, in a trademark cancellation suit, the deference due to lower court determinations regarding “hypothetical inquiries into what might have been”).

242. RESTATEMENT (THIRD), *supra* note 19 § 42 cmt. h (citing *id.* § 51 cmt. i) (“Uncertainty resulting from difficulties of proof will properly be resolved against the wrongdoer, on standard equitable grounds.”).

allocable overhead will fall on the defendant.<sup>243</sup> If the defendant can persuade the factfinder, to a reasonable degree of certainty, that it would have engaged in some other revenue-producing behavior in the absence of infringement, the defendant's relevant overhead would be allocated to reduce the profits calculated from the infringement. But, as with the calculation of profits for copyright disgorgement more generally, the risk of uncertainty from a failure of proof falls on the defendant.<sup>244</sup>

### 3. *Profits calculation in related contexts*

The counterfactual analysis, designed to place the defendant in the position it would have occupied in the absence of infringement, is consistent with the rules of overhead allocation in other cases. For example, the defendant in a disgorgement case may be considered an inverse of the lost-volume seller contemplated under Article 2 of the Uniform Commercial Code.<sup>245</sup> A lost-volume seller's damages from a breaching buyer are its expected profit, "including reasonable overhead,"<sup>246</sup> from the missed sale, under the theory that, had the first buyer performed, the seller would have made two sales instead of only one.<sup>247</sup> In calculating the lost-volume seller's profits, Article 2 is clear that overhead costs are not allocated to reduce the profits.<sup>248</sup> Only direct costs matter. The reasoning behind this disregard for overhead is clear—only by disregarding the plaintiff's overhead can we place the plaintiff in the position it would have occupied but for the breach because the plaintiff has already borne all of the overhead costs.<sup>249</sup> Reducing the seller's profits by allocating overhead toward the lost

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243. RESTATEMENT (THIRD), *supra* note 19, § 51(5)(d) ("Residual risk of uncertainty in calculating net profit is assigned to the defendant."); 4 NIMMER & NIMMER, *supra* note 6, § 14.03.

244. *See* 17 U.S.C. § 504(b).

245. U.C.C. § 2-708(2) (AM. LAW INST. & NAT. CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2017); *see also* Roach, *supra* note 34, at 540 ("Supporters of the full-absorption method must assume that an allocated portion of overhead is not a financial gain to the defendant. Yet these same courts hold that in contract claims, . . . allocation of fixed costs is a significant financial gain, and that it must be included in the remedy for the plaintiff.").

246. § 2-708(2).

247. *Vanderwerff Implement, Inc. v. McCance*, 561 N.W.2d 24, 26 (S.D. 1997).

248. § 2-708(2) (providing for "profit (including reasonable overhead)").

249. John R. Trentacosta, *Damages in Breach of Contract Cases*, 76 MICH. B.J. 1068, 1071 (1997).

sale would result in the seller effectively double-paying that portion of the overhead and would thus leave the seller in a worse position than it would have occupied but for the wrong.

A similar analysis holds true in calculating the plaintiff's damages in cases of tortious interference with contractual relations. When a defendant's profits are disgorged because it tortiously interfered with a plaintiff's contract with a third party, its profits are not offset by overhead.<sup>250</sup> And in patent infringement cases in which the plaintiff seeks its own lost profits, courts rightly do not reduce damages by allocating the plaintiff's fixed costs because "fixed costs do not vary with increases in production."<sup>251</sup> As with the Article 2 cases, reducing the plaintiff's award because of the plaintiff's overhead requires the plaintiff to pay the overhead twice.

*Manufacturers Technologies v. Cams, Inc.*<sup>252</sup> offers an example of a case in which the court's confusion regarding overhead allocation caused it to err in awarding both damages and restitution. In that case, some of the defendant's infringing software competed with the copyright holder's own software, whereas other of the defendant's infringing software did not compete with any product of the plaintiff.<sup>253</sup> Thus, the plaintiff copyright holder sought two separate awards: one for lost profits from the defendant's sale of infringing software that competed with the plaintiff's product, and the other for disgorgement of the defendant's sales that did not compete with the plaintiff's product.<sup>254</sup> The court reduced the plaintiff's award of lost profits from the competing products by allocating the plaintiff's overhead (expenditures on advertising, promotion, and selling) toward those profits, even though the uncontroverted evidence showed that the plaintiff's overhead would not have increased if it, rather than the defendant, had made the sales at issue.<sup>255</sup> This, of

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250. *Zippertubing Co. v. Teleflex, Inc.*, 757 F.2d 1401, 1412 (3d Cir. 1985).

251. *Uniroyal, Inc. v. Rudkin-Wiley Corp.*, Nos. N-75-51 (EBB), B-80-281 (EBB), 1989 WL 85643, at \*9 (D. Conn. June 27, 1989), *vacated in part on other grounds*, 939 F.2d 1540 (Fed. Cir. 1991).

252. *Mfrs. Techs., Inc. v. Cams, Inc.*, 728 F. Supp. 75, 82-83 (D. Conn. 1989).

253. *Id.* at 82-84.

254. *Id.*

255. *Id.* at 82-83. The cases the court cited to support this conclusion—*Sigma Photo News, Inc. v. High Soc'y Magazine*, 778 F.2d 89, 93-94 (2d Cir. 1985); *Wilkie v. Santly Bros., Inc.*, 139 F.2d 264, 265 (2d Cir. 1943); and *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d

course, left the plaintiff short of its rightful position with respect to the competing sales—allocating the plaintiff’s already-incurred overhead toward the plaintiff’s lost profits damages essentially forced the plaintiff to incur those same expenses twice, even though it would have incurred them only once if it had made all of the sales in question.<sup>256</sup>

Even though the court allocated overhead against the plaintiff’s lost profits damages, the court refused to allocate overhead in disgorging the defendant’s profits from sales the defendant made in markets in which the plaintiff did not compete because the defendant’s infringement was willful.<sup>257</sup> In focusing exclusively on the defendant’s willfulness, the court neglected to consider the noninfringement counterfactual and, consequently, may have left the defendant short of its “rightful position” with respect to those sales. Such confusion can be avoided if courts consider the purpose underlying disgorgement and tailor the remedy accordingly.

#### 4. *The plaintiff’s entitlement to the profits*

The analysis so far suggests how to properly calculate the wrongful gains from a defendant’s infringement, but it does not speak to the plaintiff’s entitlement to those gains. Neither the coercive view nor the punitive view offer persuasive accounts for the plaintiff’s receipt of disgorgement proceeds;<sup>258</sup> if disgorgement is purely coercive or punitive, it should not matter who receives the defendant’s disgorged profits. Unlike the coercive and punitive views, however, the corrective-justice conception of disgorgement does not focus on the

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45, 54 (2d Cir. 1939), *aff’d*, 309 U.S. 390 (1940)—all involved the allocation of the *defendant’s* overhead in calculating disgorgement.

256. See *Hamil Am., Inc. v. SGS Studio, Inc.*, No. 95 Civ. 2513(JSM), 1998 WL 19991, at \*3 (S.D.N.Y. Jan. 21, 1998), *aff’d in part, rev’d in part*, *Hamil Am. Inc. v. GFI*, 193 F.3d 92 (2d Cir. 1999) (holding that lost sales damages should be calculated by lost gross revenues minus incremental costs because “[o]nce a copyright holder has sufficient sales so that its income is sufficient to cover all of its costs, including overhead, additional sales will increase its profits to the extent that the sales proceeds exceed the costs of goods sold and any other incremental expenses”).

257. *Mfris. Techs.*, 728 F. Supp. at 84.

258. A coercive view or a punitive view might suggest that the plaintiff receives the profits only because it is in the best position to learn of the infringement, so that providing this remedy gives the plaintiff the necessary incentive to sue. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 223 (9th ed. 2014).

defendant's rightful position to the exclusion of the plaintiff. The goal of corrective justice is not merely to eliminate the defendant's profits from the wrongdoing but to undo the wrong done by the defendant *to the plaintiff*.<sup>259</sup>

Likewise, an exclusively defendant-focused view of disgorgement cases offers no account of why the plaintiff, rather than some third party, receives the profits disgorged from the defendant. Indeed, under such a view, the plaintiff is merely “the ‘accidental beneficiary’ of a disgorgement order intended . . . to prevent unjust enrichment.”<sup>260</sup> For that matter, if the defendant's but-for-the-wrong position is the sole measure of the remedy, there is no reason to limit the counterfactual to the allocation of overhead—it is at least conceivable that a situation would arise in which the defendant could convince the jury that it would have been *more profitable* if it had not infringed. With an exclusively defendant-focused view of disgorgement liability, the defendant in such a case could argue that its liability should be reduced or even completely eliminated based on the potential profit that it might have made from its noninfringing alternative.<sup>261</sup> But the relational component of the corrective-justice inquiry—and the plaintiff's corresponding moral claim to the recovery of profits derived from its property—forestalls such an argument by focusing on the interrelatedness of the defendant's wrongdoing and the plaintiff's claim-rights.

Unless the plaintiff has a moral claim to the recovery of the defendant's profits,<sup>262</sup> disgorgement will have failed at its oft-stated goal of ensuring that neither party is unjustly enriched<sup>263</sup>—the plaintiff would be unjustly enriched if it received proceeds to which it was not morally entitled. And, if the plaintiff has no moral claim to the money, then the argument that the award is punitive gains significant traction, raising several practical concerns about punitive remedies, including

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259. WEINRIB, *supra* note 105, at 17 (the remedy “consists in simultaneously removing the defendant's excess and making good the plaintiff's deficiency”).

260. Dane S. Ciolino & Erin A. Donelon, *Questioning Strict Liability in Copyright*, 54 RUTGERS L. REV. 351, 417 (2002) (footnote omitted).

261. See Gergen, *supra* note 6, at 846 (“The upshot is that if you believe disgorgement generally is limited to the gain attributable to a wrong, then you ought to give a wrongdoer credit for overhead, fixed costs, *and opportunity costs more generally* . . . .” (emphasis added)).

262. See *Taylor v. Meirick*, 712 F.2d 1112, 1120 (7th Cir. 1983) (“[T]he owner is allowed to capture the additional profit even though it does not represent a loss to him.”).

263. See *supra* notes 193–201 and accompanying text.

due process limitations on punitive awards<sup>264</sup> and escheatment of portions of the award to the state in certain jurisdictions.<sup>265</sup> Thus, we must ask whether the plaintiff has a moral claim to the disgorged sums. Under corrective justice, at least, the answer is affirmative.

We can consider the corrective-justice approach—the only approach that satisfactorily explains the plaintiff’s entitlement to the disgorgement proceeds—in part by briefly examining corrective-justice accounts of the tort system: Why should the defendant be responsible for making the tort plaintiff whole when there are other potential systems, such as placing liability on the government or on third-party cost-spreaders like insurers?<sup>266</sup>

Professor Coleman takes up this issue. He initially concludes that although corrective justice requires compensation to the plaintiff, it cannot, standing alone, justify imposing liability on the tortfeasor.<sup>267</sup> He does, however, articulate one possible reason to impose liability on the wrongdoer: “[C]laim rights impose correlative duties [such that] the victim’s right, which is grounded in corrective justice, imposes a correlative duty to repair on his injurer.”<sup>268</sup> Professor Weinrib largely agrees with this suggestion, concluding that the duty to abstain from invading property rights and the duty to repair prior invasions of property rights are different manifestations of the same duty rather than two distinct and separately arising duties.<sup>269</sup> Professors Epstein and Thomson, however, suggest a different basis for imposing wrongdoer liability, arguing that the defendant’s causation of the

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264. See *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003).

265. See 2 JOHN J. KIRCHER & CHRISTINE M. WISEMAN, *PUNITIVE DAMAGES: LAW AND PRACTICE* § 21:18 (2d ed. 2016) (collecting statutes in which some portion of punitive awards belongs to the state). It is an interesting question whether state provisions requiring portions of punitive awards to be paid to the state are preempted by federal copyright law given the field preemption that typically applies in this area. See *Berklee Coll. of Music, Inc. v. Music Indus. Educators, Inc.*, 733 F. Supp. 2d 204, 212 (D. Mass. 2010).

266. Coleman, *Corrective Justice and Wrongful Gain*, *supra* note 183, at 426.

267. *Id.* at 425–27; see also *id.* at 428–29 n.16. Coleman acknowledged that prudential considerations outside of corrective justice may justify tortfeasor liability. *Id.* He later recanted the view that corrective justice could not explain the imposition of liability on the tortfeasor. See COLEMAN, *RISKS AND WRONGS*, *supra* note 183, at 403–04 & n.7, 432–35. Coleman would later describe gain-based damages as relational between the wrongdoer and the plaintiff, but he would term these damages restitutionary justice instead of corrective justice. *Id.* at 371.

268. *Id.* at 426. Coleman initially rejected this explanation, see *id.*, but later came to agree with it, at least in part, *id.* at 318–19.

269. WEINRIB, *supra* note 105, at 90–91.

plaintiff's injury gives the plaintiff a moral claim to the defendant's liability.<sup>270</sup>

Regardless of the basis, almost all corrective-justice accounts—including Professor Coleman's later views—recognize that the tort defendant is morally obligated to restore the plaintiff's losses.<sup>271</sup> The gain-based corollary to this is that the disgorgement plaintiff has a moral claim to the defendant's profits.<sup>272</sup> This comports with our moral intuitions—most of us would agree that the plaintiff has a superior claim to the proceeds of disgorgement than does a passerby on the street. “From the perspective of corrective justice, gain-based damages for proprietary wrongs are an entitlement of the proprietor, and not merely a mechanism for protecting the integrity of property as a facilitative institution.”<sup>273</sup>

That the positive law follows this “plaintiff-entitled” approach to disgorgement is evidenced by the law's insistence on a causal connection between the defendant's disgorged gain and the invasion of the plaintiff's rights.<sup>274</sup> A plaintiff cannot recover a defendant's profits that are not attributable to the use of the plaintiff's property—this is true even if the profits were the result of the defendant's wrongful use of *someone else's* property. The only claims the plaintiff holds are for profits from the exploitation of the *plaintiff's* copyrights.

Nor does disgorgement permit the plaintiff to recover profits unrelated to the wrongdoing, no matter how egregious the defendant's misdeeds. The plaintiff is not free to disgorge all the defendant's profits for the past year if the infringing product was only one of many profitable products for the defendant. As Judge Posner—himself no corrective-justice jurisprude—has said, “If General Motors were to steal your copyright and put it in a sales brochure, you could not just put a copy of General Motors's corporate income tax return

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270. Coleman, *Corrective Justice and Wrongful Gain*, *supra* note 183, at 430–32 (chronicling the Epstein position); Thomson, *supra* note 220, at 148 & n.16.

271. See generally COLEMAN, RISKS AND WRONGS, *supra* note 183, at 318–19.

272. WEINRIB, *supra* note 105, at 119.

273. *Id.* at 126.

274. SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989) (“Since disgorgement primarily serves to prevent unjust enrichment, the court may exercise its equitable power only over property causally related to the wrongdoing. The remedy may well be a key to the SEC's efforts to deter others from violating the securities laws, but disgorgement may not be used punitively.”).



in the record and rest your case for an award of infringer's profits."<sup>275</sup> The disgorgement remedy requires a causal connection between the income received and the illicit conduct related to the plaintiff's copyright.<sup>276</sup>

Because, as the positive law recognizes, the defendant and plaintiff are intimately connected as the doer and sufferer of the same injustice, Professor Weinrib asserts that "gain-based damages should be available when the defendant's gain is the materialization of a favorable possibility—the opportunity to gain—that rightfully belonged to the plaintiff."<sup>277</sup> Professor Weinrib's assertion pairs well with others who have taken similar positions. For example, Sharpe and Waddams argue that disgorgement compensates plaintiffs for their "loss of opportunity to bargain" with the defendant.<sup>278</sup> Professor Webb rejects this compensatory view,<sup>279</sup> but his corrective-justice account<sup>280</sup> suggests that the ownership of a copyright entails a right to

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275. Taylor v. Meirick, 712 F.2d 1112, 1122 (7th Cir. 1983).

276. SEC v. Thomas James Assocs., Inc., 738 F. Supp. 88, 94 (W.D.N.Y. 1990).

277. WEINRIB, *supra* note 105, at 125. Professor Weinrib's view, in which the defendant's gains and the plaintiff's losses always correspond, suggests that disgorgement may be viewed as compensatory, and it suggests another potential counterfactual: the plaintiff's hypothetical profit if the plaintiff had decided to exploit its copyright as the defendant did. In that case, the relevant question becomes whether the plaintiff would have had to incur the costs at issue in order to exploit its copyright as the infringer did.

278. Robert J. Sharpe & S.M. Waddams, *Damages for Lost Opportunity to Bargain*, 2 OXFORD J.L. STUD. 290, 296 (1982). Sharpe and Waddams recognize that this "lost opportunity" theory "allows the plaintiff the benefit of a presumption that he would have demanded the greatest sum that the defendant would rationally have paid." *Id.* at 297. In other intellectual property contexts, this form of damages takes the form of a hypothetical negotiation, in which the measure of damages is the outcome of a hypothetical negotiation between the parties. See Layne S. Keele, *Resolving Patent Infringement Damages After ResQNet: The Dangers of Litigation Licenses as Evidence of a Reasonable Royalty*, 20 TEX. INTELL. PROP. L.J. 181, 183 (2012). In the hypothetical negotiation with parties of equal bargaining power, the parties would be expected to reach an agreement in the middle of the overlap of their bargaining ranges. Under the lost opportunity theory, the award is not only "the greatest sum that the defendant would rationally have paid," but it is slightly greater since disgorgement seeks to annul all gains of the defendant, and the rational profit maximizer would not be expected to act for no gain. See also Taylor v. Meirick, 712 F.2d 1112, 1120 (7th Cir. 1983) (Posner, J.) (recognizing that "some of the 'windfall' may actually be profit that the owner would have obtained from licensing his copyright to the infringer had the infringer sought a license").

279. See WEBB, *supra* note 189, at 197; see also *id.* at 176–78.

280. See *id.* at 236 ("There is no difficulty in describing claims in unjust enrichment as claims of corrective justice.").

“all wealth generated through its exploitation.”<sup>281</sup> And the Supreme Court said long ago that the defendant’s profits “are in fact a compensation for the injury the [plaintiff] has sustained from the invasion of his right. They are the measure of his damages.”<sup>282</sup> The goal of disgorgement, then, is not merely to take what the defendant gained from the wrongful alienation of the plaintiff’s property but also to give it to the plaintiff as the rightful owner.

## VI. CONCLUSION

The allocation of overhead in copyright disgorgement cases has vexed courts for over half a century.<sup>283</sup> The confusion stems from an understandable but misplaced focus on the culpability of the infringer—specifically, whether the infringement was willful. This focus may be a function of the coercive or punitive views of disgorgement (although, even under the coercive view, the willfulness focus is generally unnecessary under existing copyright law), or it may be a function of restitution’s historical concerns with the wrongdoer’s state of mind in certain cases. But, in any event, willfulness does not matter under the Copyright Act or under historical disgorgement principles, which treat infringers as trustees over the gains resulting from their handling of another’s property.

This Article has argued that the most logical view of disgorgement under the Copyright Act is a corrective-justice rationale under which neither party should have what rightfully belongs to the other.<sup>284</sup> The wrongdoer who produces and sells some product incorporating the copyright holder’s property generates value from the intangible property and holds a claim in counter-restitution for its expenses incurred in generating the profit, just as a defaulting trustee has a claim for expenses spent to benefit the trust. Overhead allocation, then, becomes a question of not only whether the wrongdoer can legitimately claim that the overhead enhanced the copyright value, but

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281. *Id.* at 191. According to Webb, the rightful owner is generally entitled to value generated by the defendant’s *exchange* of the owner’s property, but not necessarily value generated by the *use* of the owner’s property. *Id.* at 187–88, 191. A profitable copyright infringement—and thus, one subject to disgorgement of profits—would presumably involve an “exchange” of the protected work of authorship for money.

282. *Mowry v. Whitney*, 81 U.S. (14 Wall.) 620, 653 (1871).

283. *See supra* Part I.

284. *See supra* Parts III–IV.

also whether the overhead represents an actual expense attributable to exploitation of the copyright. This does not require conforming to an accounting fiction,<sup>285</sup> but instead requires playing out a counterfactual to determine whether, in the absence of infringement, the infringer would have spread that part of its overhead among additional products. If so, this opportunity cost represents an attributable expense, and the infringer should be permitted to allocate the overhead. If not, no allocation should be permitted. This approach furthers the general aims of disgorgement within the existing construct of the Copyright Act, and it gives the copyright holder “every dollar of advantage realized by the infringer from the infringement and no more.”<sup>286</sup>

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285. See Roach, *supra* note 22, at 1285; see also *Blurred Lines Case*, *supra* note 7, ECF No. 351, at 52–54.

286. *Levin Bros. v. Davis Mfg. Co.*, 72 F.2d 163, 165 (8th Cir. 1934) (patent infringement case).