MEMORANDUM

To: My Customer

From: Bob Kovsky

Subject: Plaintiff v. Client/Exposure to Damages

Date: January 30, 2002

Facts and Question Presented.

Plaintiff, a manufacturer of [] interface boards for personal computers, is suing approximately 10 business organizations, their principals, and a number of individuals in federal court for alleged involvement in the manufacture, importation and sale of counterfeit goods and associated software and documentation. The counterfeit goods bore the Plaintiff name and were allegedly shoddy. Client is a distributor of computers and computer parts and allegedly sold counterfeit boards. For purposes of this preliminary memorandum, I will assume that these allegations are true.

The complaint alleges eight causes of action, three based on trademark law (infringement, false designation of origin and dilution), one alleging patent infringement, one alleging copyright infringement and three based on state law.

I will assume that Client has surrendered or is prepared to surrender all counterfeit Plaintiff boards in its possession. Plaintiff can compel such a surrender (or have the counterfeit boards seized) in any event and there is no point in holding them. The chief question is Client's exposure to monetary damages.

Conclusion.

There is substantial exposure to damages, including possible treble damages or statutory damages, and Plaintiff will also have a right to recover attorneys' fees and costs. Trademark law allows for the strongest possible remedies against those who traffic in counterfeit goods. It is even possible that damages can be accumulated on the basis of separate causes of action, e.g. treble damages from trademark violations plus statutory damages from copyright violations.

The most important factors in determining exposure to damages will be the kind of information that was available to Client to put it on notice that the goods were counterfeit, such as unrealistic prices, goods imported from overseas without a gray market coloration (Plaintiff's goods are manufactured locally), atypical circumstances surrounding the purchases by Client and/or evident shoddiness of the kind alleged in the complaint.

Trademark law, in particular, imports considerations of "equity" and vests the trial court

with many ways of exercising is discretion either to reduce or increase the amount of damages, fees and costs. The factors employed by the courts are generally stated in terms such as "intentionally using" a counterfeit mark "knowing" it is counterfeit, or "willful" wrongdoing or "bad faith." However, "willful blindness" is considered the equivalent of knowledge, especially when an experienced merchant such as Client is involved.

Discussion of Authority.

For purposes of this memorandum I will be focusing primarily on trademark and secondarily on copyright law. The patent infringement claims are more of the same, only the guilty knowledge on the part of the defendant must be shown with greater clarity. The three state causes of action allow only for injunctive relief. (Plaintiff has not alleged a state cause of action under Cal. Business & Prof. Code § 14340 which allows for damages essentially the same as those allowed under federal law.)

15 U.S.C. § 1125(a) (often called § 43(a) of the Lanham Act) authorizes a civil suit against any person who "uses in commerce any word, term, name, symbol or device" that is false or misleading or is likely to cause confusion as to the origin of goods and 15 U.S.C. § 1125(c) authorizes a civil suit against any person who "dilutes" or "tarnishes" a famous mark. I will assume that the sale of shoddy goods, as alleged in the complaint tarnishes and dilutes Plaintiff's marks.

15 U.S.C. § 1114 (often called § 32 of the Act) authorizes a civil suit against any person who shall "use in commerce" any counterfeit or copy of a registered mark in connection with the sale or distribution of goods or in connection with a use that is likely to cause confusion.

Allowable damages are defined by 15 U.S.C. § 1117 (often called § 35 of the Act), and I have emphasized language that marks points where there is to be a factual determination or exercise of discretion:

Sec. 1117. - Recovery for violation of rights

(a) **Profits; damages and costs; attorney fees**

When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section 1125(a) [or] (c) of this title, or a ***willful*** violation under section 1125(c) of this title, shall have been established in any civil action arising under this chapter, the plaintiff shall be entitled, subject to the provisions of sections 1111 (requiring actual notice of registration, registration notice or ® symbol for award of damages) and 1114 of this title, and ***subject to the principles of equity***, to recover

(1) defendant's profits,

(2) any damages sustained by the plaintiff, and

(3) the costs of the action.

The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed. ***In assessing damages the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive the court may in its discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.***

(b) **Treble damages for use of counterfeit mark**

In assessing damages under subsection (a) of this section, the court shall, ***unless the court finds extenuating circumstances***, enter judgment for three times such profits or damages, whichever is greater, together with a reasonable attorney's fee, in the case of any violation of section 1114(1)(a) of this title ... that consists of ***intentionally using*** a mark or designation ***knowing such mark or designation is a counterfeit mark*** (as defined in section 1116(d) of this title), in connection with the sale of goods or services. In such cases, the court may ***in its discretion*** award prejudgment interest on such amount at an annual interest rate established under section 6621 of title 26, commencing on the date of the service of the claimant's pleadings setting forth the claim for such entry and ending on the date such entry is made, or for such shorter time as the court deems appropriate.

(c) **Statutory damages for use of counterfeit marks**

In a case involving the use of a counterfeit mark (as defined in section 1116(d) of this title) in connection with the sale, offering for sale, or distribution of goods or services, the plaintiff may elect, at any time before final judgment is rendered by the trial court, to recover, instead of actual damages and profits under subsection (a) of this section, an award of statutory damages for any such use in connection with the sale, offering for sale, or distribution of goods or services in the amount of -

(1) not less than $500 or more than $100,000 per counterfeit mark per type of goods or services sold, offered for sale, or distributed, ***as the court considers just***; or

(2) if the court finds that the use of the counterfeit mark was ***willful***, not more than $1,000,000 per counterfeit mark per type of goods or services sold, offered for sale, or distributed, ***as the court considers just***.

In the ordinary infringement case (where counterfeiting is not shown), the law is "a confusing melange of common law and equity principles. The courts have balanced several factors such as: whether defendant was willful, negligent, or innocent; whether plaintiff suffered losses in any provable amount; whether there is proof of actual confusion of some customers; and whether defendant realized profits from its infringing actions. In various cases, different courts have given widely disparate emphasis to one or more of these factors, making predictability of result a dangerous undertaking." 5 *McCarthy on Trademarks*, § 30:58.

Anti-counterfeiting legislation enacted in 1984 "added language requiring that unless the court finds extenuating circumstances, treble damages or profits and a reasonable attorney fee ***must be awarded*** to an infringed trademark owner if the defendant counterfeiter ***knew*** the goods were counterfeit and intended to offer them for sale." *Id*., § 30:94 (emphasis added) (The statutory language and a footnote make clear that the added damages also apply to reseller.) The court also has discretion to award prejudgment interest. *Id*. Such an award is "***mandatory***, except in rare cases, against one found to have been intentionally using a mark knowing it to be a counterfeit." *Id*. (emphasis added) An example of the "extenuating circumstances" that will avoid treble damages is "an unsophisticated individual operating on a small scale ... for whom treble damages would mean that that person would be unable to support his family." *Id*., n.6 (some editing for conciseness). See also 4 *McCarthy*, §§ 25:10 *et. seq.*

The cases do not cohere harmoniously. Compare *Lindy Pen Co. v. Bic Pen Co.*, 982 F.2d 1400, 1409 ("[A]n award under § 1117(b) is never automatic and may be limited by equitable considerations") with *Louis Vuitton S.A. v. Lee*, 875 F.2d 584 (7th Cir. 1988) (trial court evidently felt compassion for Korean immigrants who ran a "ragtag" storefront and sold a few obvious knock-offs - no damages awarded; ***reversed and remanded*** to a different judge: "Section 1117(b) is a severe statute." "***Willful blindness is knowledge enough***.") As to "willful blindness," see also 5 *McCarthy*, supra, § 30:94.

An exemplary case is *Ked's Corp. v. Goldstreet Holdings, Inc.*, 25 U.S.P.Q.2d 1958 (C. D. Cal. 1992). Defendant and its principal, defendant Randy Slavin, were in the merchandise brokerage business and acted as a "middleman" in the purchase and sale of footwear. Defendant sold over 50,000 pairs of shoes that were counterfeits of plaintiff's products. The court found that defendants acted willfully. "The Court bases this finding on the low price that it has already found to have been paid by Defendant Slavin for the goods as well as the shady circumstances surrounding Defendant Slavin's dealings with David Chang." Slavin admitted in deposition that he believed the price he paid would be too low a price for genuine goods. Slavin also testified that "he was told and believed that shoes he purchased were genuine KEDS brand merchandise which had been diverted from an authorized retailer to his source, Mr. David Chang." Slavin did not ask Chang for any documentation "because of a claimed industry practice to maintain secrecy as to source of even genuine goods." The goods were transferred "from one delivery truck to another at pre-arranged locations on the streets of Los Angeles."

The Court rejected Slavin's explanation. Even though the Court found "that the counterfeit shoe itself was of sufficient quality and similarity to the genuine goods that it alone did not put Defendant Slavin on notice of a possible problem as to the source or authenticity of

the goods," the Court found that "the irregularity of the transaction, including the fact that Mr. Slavin admits that he was instructed by his source to make a wire transfer of money to Korea for goods that were supposedly already in the United States ... ***imposed upon Defendant Slavin a duty to inquire as to the authenticity of the goods and to establish a good faith belief that the goods did not infringe Plaintiff's trademark rights***." (emphasis added)

Under the rules of § 1117(b), plaintiff can obtain damages in the amount of defendant's profits and this amount will be trebled if defendant had knowledge. In *Goldstreet Holdings*, the court accepted the testimony of a witness of plaintiff that the cost of the shoes to Slavin was $6.00 a pair and rejected Slavin's testimony that he paid $13.00 a pair. because of the absence of documentation and the fact that, at $13.00 a pair, Slavin would not have made much profit (it was established that he resold the shoes at $13.25 - $13.50 a pair). Once plaintiff proves the amount of defendant's sales, the burden shifts to defendant to prove its costs and other deductions. The court did a quick calculation, found total profit of $367.526.40 and entered judgment for $1,102,579.20. For a more detailed accounting procedure, see *Rolex Watch USA, Inc. v. Meece*, 158 F.3d 816 (5th Cir. 1998).

Alternatively, plaintiff can claim damages by way of its lost profits on a per board basis, as in *Intel Corporation v. Terabyte International, Inc.*, 6 F.3d 614 (9th Cir. 1993), where the court apparently applied only "ordinary infringement" damages under § 1117(a) even though it repeatedly used the word "counterfeit." Computer chips were remarked (relabeled) by defendant' supplier to appear to operate a higher speed than that designated by manufacturer. "Terabyte's officers testified at trial they were not aware of and could not detect counterfeit chips. They argued that they tried to inspect the [chips] and that reliance on the integrity of their sources was reasonable. Nevertheless, substantial evidence contradicted their testimony...." Factors included the price paid for the chips when Intel would have sold such chips to its distributor at a higher price. Terabyte had been told by a complaining customer about one way of detecting the remarking. "[Terabyte] purports to be a long-time player in the chip market. It stretches credulity to be told that Terabyte simply could not ascertain when an Intel chip had been covered over and then remarked." The court also awarded plaintiff over $200,000 in attorneys' fees, but this award was reversed and remanded because plaintiff had submitted only summaries of its hours worked. This case discussed rules relating to attorneys' fees at length (the test is "malicious, fraudulent, deliberate or willful") and cited the rule from *Lindy Pen*, supra, that an award under § 1117(b) may be limited by equitable considerations.

Recall that, under § 1117(c), the plaintiff can elect statutory damages that will be imposed "as the court considers just" in an amount of not more than $100,000 per counterfeit mark "per type of goods ... sold or offered for sale, or distributed", except that, if the court finds that the use of the counterfeit mark was "willful," the statutory damages can be up to $1,000,000 per such type. See 5 *McCarthy*, supra, § 30:95. It would appear from the complaint, ¶¶ 19-21 that Plaintiff is alleging infringement as to ***two*** types of boards although it may ultimately claim more (see ¶ 21 identifying three models).

Damages for infringement are also available under copyright law and the law is similar to that governing trademark infringement. 17 U.S.C. § 504. The statutory damages are not more

than $20,000 "with respect to any one work" "as the court considers just," except, if the infringement was committed "willfully," that amount can be increased to $100,000. Applications for copyright registration attached to the complaint as exhibits have not been sent to me, but the number should be easily determined. Courts angered over the actions of counterfeiters have ***added*** statutory copyright damages to amounts based on defendant's profits awarded under trademark law. *Nintendo of America v. Dragon Pacific International*, 40 F.3d 1007 (9th Cir. 1994); *A&M Records, Inc. v. General Audio Video Cassettes, Inc. (Abdallah)*, 984 F.Supp. 1449 (C. D. Cal. 1996).