

Chapter 5

Licensing Disputes

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5.1 Introduction

While Ben Franklin may have believed that the only certain things in the world were “death and taxes”, if merchandising had been popular in the 18th Century, he would have added a third--someone will try to knock off a successful property. We live in a world where infringements and counterfeiting are a way of life, particularly in some countries where copying is a lucrative industry. Unfortunately, the owner of every successful property will face the problem of infringement or counterfeiting at some point in time.

The drill for every property owner is to take appropriate steps to protect their property and try to stay abreast as much as possible of what is happening in the marketplace. In the licensing industry, however, the reality is that licensees will be the closest party to the problem since they are the ones who are actually in the marketplace facing competition from unlicensed products every day and, as such, will normally bring these issues to the attention of their licensors.

For a successful property owner, trying to stay ahead of the infringers and counterfeiters can be a full time job and in most instances will require aggressive action. Because of the profit potential, the counterfeiting industry has become very good at their trade and property owners need to take swift, aggressive action against them to keep the problem from escalating. Property owners who believe that they can simply kick back and let their licensees fend for themselves against unlicensed (and non-royalty paying) competition, will soon see their licensing program evaporate. Protecting the licensee’s right to sell competition free is one of the obligations of a licensor and a prime reason why a licensee is willing to pay for the right to use a licensed property. Successful licensors understand that very basic issue.

5.2 The Counterfeiting Industry—a Growing Market

Counterfeiting is the deliberate use of another’s intellectual property, including trademarks, product designs and copyrights including, the use of a false trademark that is identical with or substantially indistinguishable from a registered trademark or the passing off of a product whose design is similar or identical to the design of the authentic product or the act of copyright piracy where an audio-visual work is copied and distributed on an unauthorized basis. Counterfeiting is not simply the infringing of another’s intellectual property rights, but it is the blatant duplication of such property right in order to have the consumer believe that the product was an original....even though its selling price may be a small fraction of the original.

How big a problem is counterfeiting? It’s huge and, sadly, it’s a growing market despite the best efforts of property owners and governments to stem the tide. The reason for its growth is simple—one can sell a great amount of

product without the need for the type of overhead expenses that a property owner normally incurs in developing and marketing a unique product. The counterfeiter simply skips to the last two steps in the process. It knocks-off the product and sells it for a fraction of the price that the genuine product, typically, through less than reputable channels of distribution.

The overall problem is bad and it's getting worse. For example, in 2008 the U.S. Customs and Border Protection ("CBP") and U.S. Immigration and Customs Enforcement ("ICE") announced seizure of more than \$272.7 million of counterfeit and pirated goods, which represents a 38% increase over the prior year. More significantly, it represented almost a 300% increase since 2002. The most frequently seized product was footwear, which accounted for 38% of the total seizures and 98% of which originated in China which is, by far, the leading source of counterfeit merchandise. Counterfeit product from China, India and Hong Kong constituted about 94% of all counterfeit product seized by ICE over the same period.

The United States is not alone in the fight against counterfeit merchandise. In 2008, 178 million counterfeit items were seized by European Customs authorities, up from 79 million in 2007; 44% of all products seized were pirated CDs and DVDs; 23% were counterfeit cigarettes and 10% were counterfeit clothing. Of all counterfeit goods seized, 54% originated from China, however a majority of the counterfeit food and beverages that were seized came from Indonesia, while a majority of the phony pharmaceuticals came from India.

Counterfeiting is not a victimless crime, harming both the property owner and the consumer. It steals the identity and good will developed by the property owner over decades of use as well as robs the consumer of the comfort and reliability that it has when it buys an otherwise branded product. More critically, it can put the consumer in danger if the counterfeit product is not manufactured to the quality levels of the actual product. It also creates confusion on their part, between the genuine product and the counterfeit product and may destroy the consumer's confidence in a particular brand, thinking that the poorly manufactured counterfeit product is actually the genuine item.

Moreover, it has an economic harm for all involved. It deprives municipalities, states and countries of tax revenues derived from the sale of genuine products, not to mention the property owners and their licensees of sales revenues from the sale of such genuine products.

When licensing executives think of counterfeiting, they focus mainly on designer brands and toy products which are certainly areas of great counterfeiting activity. Unfortunately, the problem is far more widespread than that. Counterfeiting activity is alive and well in the following industries:

- Designer Products & Clothing
- Automotive & Aircraft Parts
- Food
- Pharmaceuticals
- Toiletries/Cosmetics
- Toys
- Entertainment & Recording Industries

The most copied designer brands each year include BURBERRY, LOUIS VUITTON, GUCCI, CHANEL LACOSTE and CARTIER for a variety of different goods. Licensed footwear such as NIKE AIR JORDAN, ADIDAS and PUMA are similarly the target of many counterfeiters as are licensors such as NIKE and ABERCROMBIE & FITCH who license “sporty” articles of clothing.



One of the largest seizures of counterfeit clothing occurred in 2003 when \$7 million in knock-off t-shirts and sweatshirts were seized from the home and warehouse of William Haskell Farmer, who had been selling the products to 191 stores throughout the United States. Farmer would eventually plead guilty to a felony crime of trafficking in a massive counterfeit clothing operation.

The problem encompasses licensed apparel as well. For example, Customs seized 15,653 counterfeit items at the 2009 Super Bowl in Tampa worth \$1,826,562, which was up significantly from the prior year in Arizona, where they seized 10,212 counterfeit items worth \$542,120. It was estimated that of the \$596 million of Bob Marley merchandise sold every year, only \$4 million of it is authorized or licensed.

Toy manufacturers who are already very conscious of problems associated with the use of such chemicals as lead and phthalates in their products, find themselves encountering knock-offs with levels of such chemicals at as much as 100 times the acceptable limits, compounding the damage to their public reputation.

Moreover, counterfeiters have little regard for CPSC requirements regarding the use of small, sharp, breakable parts that can pose a choking hazard to children. Counterfeit sunglasses also regularly fail to produce the ultra-violet protection claimed and often shatter easily—again posing a safety hazard for the user. When they carry a name such as RAYBAN, however, they harm the brand by association, albeit an unlicensed or unauthorized association.

The entertainment and software industries are regularly impacted by counterfeiting, from the early release of bootleg motion pictures DVD's appearing in public even before they are shown in theaters, to counterfeit versions of popular software products. In 2002, John Sankus Jr., was sentenced to 46 months in prison for leading an international piracy ring responsible for copying and distributing software, games and movies. He had headed an international software piracy group called DrinkorDie which included 60 members from numerous countries and whose biggest claim to fame was distributing copies of Windows 95 two weeks before the official release of the operating system.



Clearly, for the licensing industry counterfeiting is a problem, but it's more of an economic problem than a safety one. There are certain industries, however, where it also poses a safety hazard for the consumer. For example, it was reported that a mother and her child were killed in an automobile accident when a counterfeit brake pad made out of wood chips failed. A faulty clutch made of counterfeit parts was the cause of a helicopter crash that killed a traffic reporter. It was subsequently discovered that more than 600 helicopters had been equipped with counterfeit parts putting every literally millions of people at risk. A Norwegian plane crash killing 55 people resulted from counterfeit bolts.

The food and beverage industry is another target for counterfeit merchandise and, again, they put lives at risk. For example, authorities discovered a counterfeit version of Similac baby formula sold at Safeway and Pak n' Save stores in a total of 16 states, which causes rashes and seizure in some users while counterfeit butterscotch candy illegally bearing the Borden brand-name was found in a stores in boxes with no expiration dates.

Another industry that is plagued by counterfeit merchandise is the pharmaceutical and cosmetics industry where the use or ingestion of inferior counterfeit product can prove deadly. For example, it was reported that a liver transplant recipient received a counterfeit version of Epogen to treat anemia. Because it was at only 5% of strength, instead of improving the boy's condition, it caused excruciating aches and spasms. The FDA recalled \$7 million worth of pumps used during open-heart surgery that contained

malfunctioning counterfeit parts, while Searle discovered that over 1 million counterfeit birth control pills had been distributed to unsuspecting women, resulting in unwanted pregnancies and irregular bleeding.

Proctor & Gamble found that it had to place national advertisements informing consumers that counterfeits of its Head & Shoulders shampoo on store shelves could harm users with weakened immune systems. Additionally, a host of cosmetics manufacturers have seen counterfeit versions of their product enter the market containing industrial solvents and carcinogens which may cause severe allergic reactions when applied to the skin.

Counterfeiting also has a serious political impact. Investigators have found that Chinese organized crime syndicates rely on counterfeiting as a source of tax-free income and terrorist organizations are at least partially funded by trafficking in counterfeit goods. For example, it has been established that at least a portion of the funding of the first World Trade Center bombing came from counterfeiting revenues. Northern Ireland terrorist groups were found to have funded their activities through the sale of counterfeit perfumes, veterinary products, videos, software and pharmaceuticals. Past raids of counterfeit operations in New York and New Jersey which seized counterfeit designer handbags containing heroin have established a clear tie between drug smuggling and counterfeiting.

The economic impact of counterfeiting is staggering. The International Chamber of Commerce estimates that 7% of the world trade is in counterfeit goods and that the counterfeit market is worth \$ 350 billion. U.S. companies lost an average of 22% in 2009 as a result of counterfeiting. Total loss to the United States as a result of counterfeiting was estimated at \$2 billion, with 100,000 jobs lost. Fortune 500 companies each spend an average of between \$2 and \$4 million per year to combat counterfeiting. Some reported spending up to \$10 million.

Certain industries are harder hit than others. For example, the software industry loses between \$12-16 billion a year because of counterfeiting--more than 40% of all software industry revenues. In some countries, more than 90 percent of computer software sales are illegitimate copies. U.S. automobile manufacturers and suppliers lose \$12 billion a year in revenue worldwide because of the sale of counterfeit parts. The FTC estimates that auto manufactures could hire 210,000 more workers by eliminating counterfeit auto parts.

5.3 Identifying Counterfeit Product & Finding the Counterfeiters

Since one of the principal attractions to the consumer of a counterfeit product is cost—using that same yardstick is perhaps the simplest and easiest way to identify the product. The old adage, “if something is too good to be true, it usually isn’t” applies here. If the price of a product is so far below that of what the genuine product is typically sold for, the red flags should start to go up.

Since counterfeit product is typically made on the cheap, a closer inspection of the product will typically reveal whether it’s real or fake. Telltale signs that a product is counterfeit are:

- Packaging with blurred lettering or labeling
- Misspelling of words or altered product names
- Drastic changes in product content, color, smell, or packaging
- Products or packaging lacking manufacturer’s codes, trademarks and/or copyrights,
- Products with unusual claims and warranties

Similarly, counterfeit products are most often sold through non-typical channels of distribution since the better retailers will not normally carry such products.

Many property owners regularly employ private investigators and even set up “sting” operations to identify counterfeiters. These investigators visit major retail stores, canvas street vendors in known counterfeiting areas, attend trade shows, review magazines and trade publications and regularly monitor the Internet to find dealers who are selling counterfeit merchandise. Similarly, they target those markets that typically traffic in such products, e.g., flea markets, Canal Street and Times Square in New York City and other places where counterfeit products are typically carried.

5.4 Steps to Take Against Infringers

[A] Cease and Desist Letters

A preliminary to litigation often is the sending of a cease and desist letter. Although such letters are not a prerequisite to litigation, a cease and desist letter may be the appropriate course where an infringement is likely to be discontinued short of litigation. For example, a small retail shop that is innocently selling infringing items is likely to cooperate in discontinuing the sale of such items. The mailing of a cease and desist letter to such an entity is thus likely to save the substantial expense of time and money encountered in a full-blown litigation. A policy of suing first and asking questions later is sometimes akin to using an elephant gun to kill a flea.

One risk in sending a cease and desist letter is that it can be viewed as a threat of litigation that entitles the accused infringer to bring an action of their own against the owner of the licensed property to determine whether an infringement has occurred. The accused infringer can bring such an action in a court that is more favorable to it either because of the geographic proximity to its place of business or because of the court's more favorable attitude toward defendants.

[B] Keeping a Perspective on Litigation

When all is said and done, the property owner may have no alternative but to commence a legal action to halt infringing or counterfeiting activities. Once the decision to bring suit has been made, the legal action should move forward as quickly as possible. Delay can adversely affect the ability to obtain a temporary restraining order or preliminary injunction. Delay in bringing a motion for preliminary injunction can result in denial of such a motion. Such delay indicates the absence of irreparable harm.

There are other reasons for prompt action. Sales of infringing products can cause lost revenues to licensees and loss of royalties to the licensor. The presence of infringing or counterfeit products in the marketplace can also diminish the exclusivity and goodwill associated with the licensed property. A greater concern arises when a counterfeit product causes injuries due to some product defect. Even if the property owner can ultimately avoid liability for the injury once the product is shown to be counterfeit, there is always the risk of loss of reputation from the adverse publicity of a lawsuit initially filed against the property owner.

In deciding to go to court, it is critical to be forever mindful that litigation is merely a means to an end, namely, protection of the licensed property. Litigation should never be pursued thoughtlessly, since at the very least it provides the accused infringer with the opportunity to challenge the validity of the licensed property. Litigation for litigation's sake is never the appropriate course.

Care should be taken so that litigation does not spin out of control and take on a life of its own. As long as the objective remains protection of the licensed property and the licensing program, litigation will remain a helpful tool in this pursuit. In this context, hopefully cooler heads with more objective viewpoints will prevail whenever possible. Maintaining this perspective will also enable the property owner to continue to pursue settlement negotiations during the litigation with a view toward resolving the dispute short of an actual trial. The achievement of such a settlement on solid business grounds is usually preferable to a roll of the dice casting fate to the decision of a judge or jury.

This trier of fact is unlikely to have the same appreciation as the parties to the subtleties of their businesses or to the type of settlement that might work best within the context of the realities of the marketplace.

[C] Theories of Litigation

The actual theory that a property owner may pursue in litigation will depend, in large measure, on the property, how it has been protected, and how it is being used by the alleged infringer or counterfeiter.

When the property has been registered as a trademark with the USPTO and the defendant is using the trademark or a mark that is confusingly similar to the registered mark on like or similar goods, the federal trademark laws (commonly referred to as the Lanham Act) provide very strong and enforceable remedies. While an action for the infringement of a registered trademark can be brought in either state or federal court, most such actions are brought in federal courts, which have original jurisdiction over such cases.

In order to prevail in such actions, the property owner must first establish that it is the owner of the registration which is normally satisfied by presenting a copy of the registration. That is usually the easy part. The trademark owner must also establish that the mark is valid and protectable and that the accused infringer is using the mark in a manner so as to create consumer confusion, i.e., the accused infringer's use of the trademark is likely to cause confusion in the marketplace.

The first element, i.e., that the mark is valid and protectable becomes an issue in most litigations. If the owner has been using the mark for more than five consecutive years, which will aid significantly in meeting the standard. The issue of whether the accused infringer is using the mark in such a manner as to be likely to cause confusion, however, is the harder part.

The standards or tests to determine whether a likelihood of confusion exists varies from state to federal circuit and is fact intensive. Generally speaking, courts will look at the relative strength of the mark, the differences between the registered mark and the accused mark, the differences, if any, in the goods or services, and the channels in which the marks are being used. The issue of likelihood of confusion is far too intricate to discuss in a book dedicated to the Basics of Licensing. This is an issue where the property owner needs to consult with its intellectual property counsel to assess the strength or weakness of the claim.

Section 43(a) of the Lanham Act also provides relief for unregistered marks, trade dress and for false advertising claims where the accused infringer's use creates a false designation of origin, or a false or misleading description of fact

or makes a false or misleading representation of fact. The courts have given a broad interpretation to this section, which offers protection against a variety of forms of unfair competition. It is not necessary to own a federal trademark registration in order to bring a claim under Section 43(a). Causes of action under this section typically involve infringement of unregistered marks or trade names, infringement of trade dress or product configurations, and false advertising claims.

In order to prevail on a Section 43(a) claim, the property owner must establish that they are likely to be damaged by such false designation, etc. and that the accused party has affixed such false designation to products or containers that are used in commerce.

The standard for determining a claim under Section 43(a) is the same as for trademark infringement, namely, whether the false designation, description or representation is likely to cause confusion. The property owner must establish ownership of the property, that the property is capable of functioning as a mark or other indication of source or sponsorship, and that the accused activity is likely to cause confusion. The same factors will be considered in determining the likelihood of confusion.

The federal and state anti-dilution laws provide another means of protecting licensed marks. These laws are directed against the gradual whittling away or dispersion of the distinctive quality of trademarks through their use by third parties and are aimed primarily at protecting well-known or famous trademarks. Unlike infringement, where it is necessary to prove likelihood of confusion, the owner of the mark must establish that the accused infringer's use would blur the mark's product identification or tarnish the goodwill associated with the mark.

The remedies obtainable for a successful party in a Lanham Act action are a nationwide injunction against use of the mark by the accused party as well as an award of damages, typically measured by lost profits of the trademark owner.

In addition to federal remedies for trademark infringement and counterfeiting, a number of remedies under state and common law also exist. The standard of proof for such causes of action is essentially the same as for federal Lanham Act claims, namely, likelihood of confusion.

The copyright laws can be used to enforce copyrighted properties. Actions for copyright infringement are brought exclusively in federal court and may be brought in any court having jurisdiction over an accused infringer. Obtaining a copyright registration is a prerequisite to filing a suit for copyright infringement. In addition, the copyright law establishes incentives for early registration of a copyrighted work. Unless the work is registered within three

months after it is first published, the copyright owner will be precluded from recovering certain statutory damages and attorney fees.

In order to prevail in a copyright action, the property owner must establish that they own the copyright in the property and that the infringement occurred while they were the owner of the work. In addition, they must establish that they had obtained a copyright registration in the work and that the accused infringer violated such rights by making and distributing copies thereof.

The *sine qua non* of any copyright case is proof of copying. Unless the property owner can show that the accused infringer copied the copyrighted work, there can be no infringement. Consequently, independent creation of the accused work is an absolute defense to a claim of infringement. Of course, an accused infringer does not usually admit to copying, and so the courts have accepted circumstantial evidence of copying. Thus, the licensor can establish copying by showing that the accused infringer had access to the copyrighted work and that the two works are substantially similar.

In defense of a claim of copyright infringement, the accused may contend that its activity constituted a fair use of the copyrighted work. Such a fair use will typically involve use of the copyrighted work for purposes of criticism, comment, news reporting or teaching. Use of the copyrighted work in a parody may also constitute a fair use. The courts will recognize a right to parody a licensed work, so long as the parodying work is a legitimate attempt to parody and not merely a justification to exploit the copyrighted work.

Sometimes an act of infringement of a trademark or copyright can rise to the level of counterfeiting. In addition to using the same or a similar property on the same or similar goods in a manner that is likely to deceive the public, counterfeiting involves the element of fraudulent intent. Thus, while infringement can be innocent or unintentional, counterfeiting also involves an intent to deceive. Because of this added element of intent, the counterfeiter typically attempts to design a product that looks as much as possible like the licensed property.

Litigation against trademark counterfeiting can be brought under the Trademark Counterfeiting Act, which provides both civil and criminal penalties for persons who knowingly use a counterfeit mark when intentionally trafficking in goods or services.

A mark is not counterfeit if it is used by an authorized person in connection with goods or services for which authorization has been obtained, where existing remedies are still available under the Lanham Act, and where there was authority to use the mark at the time of the manufacture or production of allegedly unauthorized goods.

Actions for counterfeiting can be brought in both civil and criminal court. Civil actions for counterfeiting are brought by the trademark owner under the Lanham Act which provides for the seizure of counterfeit goods without notice to the counterfeiter. An award of treble damages or profits and attorney fees is mandated in the absence of extenuating circumstances. The Act requires a seizure order to be based on a sworn affidavit setting forth sufficient facts to support the seizure order. The party seeking the order must post an adequate bond.

Criminal actions for counterfeiting are federal prosecutions brought by the applicable U.S. Attorneys' Offices. In order to establish a criminal cause of action, the accused party must have intentionally trafficked in the goods or services and must have knowingly used the counterfeit mark in connection with such goods or services. It must be shown that the accused party knew the mark was counterfeit, that it was spurious, that it was used in connection with trafficking in goods and services, that it was identical or virtually indistinguishable from another mark, and that it is likely to cause confusion. An individual found guilty under the Act is liable for a fine or imprisonment or both.

Since virtually all counterfeiters operate in secrecy under fictitious names keeping minimal business records, by the time a normal civil action were to run its course, a counterfeiter is likely to have disappeared along with the evidence. As a consequence, most property owners will initiate any actions by first seeking temporary restraining orders and seizure orders against counterfeiters. These orders can be obtained *ex parte* without any notice to the counterfeiter. In order to obtain such orders, however, the party seeking the order will have to explain to the court why it would be injurious to be required to give notice to the accused party.

In the case of a trademark or a copyrighted work, the property owner should be able to demonstrate a likelihood of success by claiming ownership of a federal trademark or copyright registration and by a comparison of the genuine and counterfeit products.

A motion for an *ex parte* seizure order will often accompany a motion for a temporary restraining order. Where the risk of loss of evidence is acute, a court may permit the property owner to have a U.S. Marshall or other designated representative enter the premises of the accused party and seize counterfeit merchandise along with pertinent books and records. The seized items will be maintained in the custody of the Marshall until the hearing on the motion for preliminary injunction.

Seizure orders are also an effective means of protecting licensed properties used on merchandise sold in conjunction with entertainment and sporting events. Such orders will issue against known counterfeiters and various “John Does” who are likely to be selling bogus merchandise during a specific time and at a specific location on the day of the event. The order will authorize the seizure of such merchandise, much to the delight of the legitimate licensees who have spent time and money in producing authorized merchandise for sale at the event.

Even where the property owner does not seek ex parte relief, there will often be a motion for a preliminary injunction at the outset of the litigation. Such an injunction will require the accused party to discontinue the sale of infringing or counterfeit merchandise, thereby protecting the property owner from further injury pending final disposition of the action. A preliminary injunction will be granted only on notice to the accused party and after a hearing before the court. The court can also hold an evidentiary hearing with live testimony from both sides. If this is done, a court may decide to consolidate the preliminary injunction hearing with a full trial on the merits, thereby expediting the entire proceeding.

The showing of likelihood of success on the merits and irreparable harm will be similar to that discussed in connection with the obtaining of ex parte relief. The greater the similarity of the products, trademarks and copyrighted elements, the greater will be the likelihood of success. Any evidence of actual instances of consumer confusion, or of willful or intentional conduct by the accused party, will also go a long way in supporting the issuance of a preliminary injunction.

Another effective tool for obtaining expedited relief or for narrowing the issues to be tried is the motion for summary judgment. A court will enter summary judgment in favor of either the property owner or the accused infringer if there are no genuine issues of material fact existing as to a claim of infringement or counterfeiting. Since any contested factual issues will always be resolved in favor of the nonmoving party, the facts should be clearly developed before seeking summary judgment. Thus, only in the case of a clear counterfeit or infringing product would such a motion be appropriate. Since a summary judgment motion can be brought at any time prior to trial, fact issues may be resolved during the course of discovery so as to make the case ripe for summary disposition at a time closer to trial. A grant of full or partial summary judgment will avoid the expense of time and money in trying the issues disposed of by summary judgment. It is therefore a useful litigation tool.

Should the case ultimately go to trial, there are three critical elements to an effective trial presentation: preparation, preparation and preparation! The job of the property owner is to convince the trier of fact, whether a judge or a jury, of

the merits of the claim of infringement. Given the heavy case loads in most courts, the property owner will likely be given only a limited amount of time to make its case of infringement. With careful preparation of witnesses and exhibits, this can be done. The purpose of a trial should be to educate, not to confuse or bore the trier of fact.

The elements of a claim for trademark, copyright, and patent infringement have been set forth above. Each of these elements should serve as a road map in trial preparation and presentation. Omissions of evidence on a critical element could result in a dismissal of the complaint and the close of the property owner's case.

The goal of the property owner is to stop infringement of the licensed property. This is accomplished by a permanent injunction. Even where a temporary restraining order or preliminary injunction has issued, these must be converted into a permanent injunction either through a settlement with a final judgment and injunction on consent, or an award of a permanent injunction after a full trial on the merits. In some instances, a court may also require recall of infringing products or the placement of corrective advertising. Since infringement of a licensed property cannot be compensated entirely by monetary relief, the courts have come to recognize the need for equitable injunctive relief in such actions. Courts will also continue to enforce an injunction after trial through civil and criminal contempt proceedings.

Of course, there are sometimes instances where monetary relief is appropriate. An award of damages may require more than a showing of merely a likelihood of confusion. Evidence of actual confusion may be necessary to warrant a damage award. Similarly, courts will generally look for evidence of willful or predatory conduct before awarding profits. Awards of punitive damages may also be available under certain state law claims.