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# *JCW Investments, Inc. v. Novelty, Inc.*

*Lisa Morrow\**

## **I. INTRODUCTION**

Tekky Toys, the creative geniuses that originated the idea for a farting plush doll, are very protective of their masterpiece – Pull My Finger® Fred. After discovering that Novelty, Inc. was producing similar farting dolls, Tekky Toys sued for copyright infringement, trademark infringement, and unfair competition. The U.S. Court of Appeals for the Seventh Circuit reprimanded Novelty, Inc. severely when it upheld the district court's award of damages. The Seventh Circuit awarded damages based on lost profits resulting from copyright and trademark infringement, punitive damages under state unfair competition law, and attorneys' fees worth approximately twice the total damages awarded. But was it really fair to allow Tekky Toys to recover compensatory damages under the Lanham Act, plus punitive damages under a state law claim for unfair competition, when the Lanham Act provides that damages for trademark infringement "shall constitute compensation and not a penalty?"<sup>1</sup> Or should the Lanham Act preempt the state law remedy allowing punitive damages?

## **II. FACTUAL BACKGROUND**

Tekky Toys received a copyright for their "plush toy with sound" in February 2001 under its "Pull My Finger" mark. Pull My Finger® Fred "is a plush doll and when one squeezes Fred's extended finger on his right hand, he farts. He also makes somewhat crude, somewhat funny statements about the bodily noises he emits, such as 'Did somebody step on a duck?' or 'Silent but deadly.'"<sup>2</sup> After seeing Fred at a tradeshow in Hong Kong, Todd Green, President of Novelty, Inc., went back to his art director and had her design a similar doll, which they named Fartman. Novelty began manufacturing their farting dolls in October 2001. In his testimony, Green admitted to basing the Fartman doll on Pull My Finger® Fred.<sup>3</sup> In the Seventh Circuit's opinion, Justice Wood described the striking similarities of the two dolls:

[B]oth are plush dolls of middle-aged men sitting in arm-chairs that fart and tell jokes. Both have crooked smiles that show their teeth, balding heads with a fringe of black hair, a rather large protruding nose, blue pants that are identical colors, and white tank tops. On the other hand, Fartman has his name emblazoned in red across his chest, his shoes are a different color from Fred's, as is his chair, and Fartman wears a hat. In the end, despite the small

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1. 15 U.S.C. § 1117(a) (2006).
2. *JCW Invs., Inc. v. Novelty, Inc.*, 482 F.3d 910, 912 (7th Cir. 2007).
3. *Id.* at 913.

cosmetic differences, the two dolls give off more than a similar air. The problem is not that both Fred and Fartman have black hair or white tank tops or any other single detail; the problem is that the execution and combination of features on both dolls would lead an objective observer to think they were the same.<sup>4</sup>

Tekky Toys initiated this suit against Novelty, Inc. in March 2002 after learning about Fartman.

### III. DESCRIPTION OF PLAINTIFF'S CLAIM

Tekky Toys filed this action in the U.S. District Court for the Northern District of Illinois, alleging that Novelty, Inc.'s actions constituted copyright infringement, violations of the Lanham Act, violations of the Illinois Unfair Deceptive Trade Practices Act, and unfair competition under state common law.<sup>5</sup> The district court's jurisdiction was based on subject matter jurisdiction over the federal claims (copyright and trademark infringement) and supplemental jurisdiction over the state law claims. Tekky Toys' federal cause of action for trademark infringement is more particularly described in its Amended Complaint:

Novelty's use of the "Pull My Finger" mark and sales of its allegedly infringing toys "constitutes use of a false designation of origin, description and representation . . . [and] wrongfully and falsely designates, describes or represents Plaintiff's goods, causing confusion, reverse confusion, mistake and deception as to the affiliation, connection, or association of Novelty's goods with Plaintiff" in violation of *Section 1125(a)* of the Lanham Act (federal unfair competition).<sup>6</sup>

Tekky Toys' state law claim was based on the argument that Novelty engaged in unfair competition in violation of Illinois law by misappropriating Tekky Toys' "valuable property rights," and by trading on the goodwill represented by Tekky Toys' products, which was likely to cause confusion and deceive the public.<sup>7</sup> The pleadings illustrated that the state law unfair competition claim mirrored the federal law unfair competition claim. However, the state law claim was broader and potentially easier to establish; thus a plaintiff who can prove federal unfair competition will likely prevail on the state law claim as well.

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4. *Id.* at 916.

5. *JCW Invs., Inc. v. Novelty, Inc.*, No. 02-C-4950, 2003 U.S. Dist. LEXIS 3077, at \*2 (N.D. Ill. Mar. 4, 2003).

6. *Id.* (quoting Amended Complaint at 5, *JCW Invs., Inc. v. Novelty, Inc.*, No. 02-C-4950, 2003 U.S. Dist. LEXIS 3077 (N.D. Ill. Mar. 4, 2003)).

7. *Id.* (quoting at Amended Complaint at 6, *JCW Invs., Inc. v. Novelty, Inc.*, No. 02-C-4950, 2003 U.S. Dist. LEXIS 3077 (N.D. Ill. Mar. 4, 2003)).

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#### IV. PROCEDURAL AND SUBSTANTIVE HISTORY

Ruling on a pre-trial motion, the district court was faced with the difficult question of whether the Lanham Act preempts state law remedies for unfair competition. After two unsuccessful attempts, Tekky Toys filed a motion to compel an answer to its discovery request for Novelty's financial statements and tax returns. Novelty refused to produce the documents on the basis of irrelevance, but Tekky claimed that the financial records were relevant to their state law claim for unfair competition "because punitive damages are an available remedy for unfair competition" in Illinois.<sup>8</sup> In response, Novelty argued that when state law unfair competition claims mirror claims made under the Lanham Act, the state law remedies are preempted by the Lanham Act because punitive damages are disallowed by the Lanham Act.<sup>9</sup> After examining the legislative history and the plain language of the Lanham Act, the district court concluded that "[a]bsent such plain language or evidence of Congressional intent to the contrary, we decline to find that the Lanham Act preempts remedies under state law, but does not preempt the state common law itself."<sup>10</sup>

Both parties moved for summary judgment, and the district court found in favor of Tekky Toys, ultimately awarding them: \$116,000 for lost profits on the copyright infringement claim; \$125,000 for lost profits on the trademark infringement claim; \$50,000 in punitive damages under the state unfair competition law; and \$575,099.82 in attorneys' fees.<sup>11</sup> Novelty appealed the judgment, claiming that the Lanham Act preempted the Illinois punitive damages remedy for unfair competition. This issue was one of first impression because "[o]ther courts have upheld awards of punitive damages for unfair competition when a compensatory award was also given under the Lanham Act, but none of the courts discussed whether punitive damages should be available."<sup>12</sup>

#### V. COURT OF APPEALS' HOLDING AND OVERVIEW OF RATIONALE

After analyzing the statutory language and analogous case law, the Seventh Circuit determined that the Lanham Act did not have broad preemptive reach and that the additional state law remedies did not interfere with the enforcement of the Lanham Act.<sup>13</sup> Consequently, the court held that the Illinois punitive damage remedy for unfair competition survived the Lanham Act's prohibition against penalty awards, thus affirming the \$50,000 award for punitive damages.

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8. *Id.* at \*4.

9. *Id.* at \*5.

10. *Id.* at \*10-11.

11. *JCW Invs., Inc. v. Novelty, Inc.*, 482 F.3d 910, 913 (7th Cir. 2007).

12. *Id.* at 918 (alteration in original).

13. *Id.* at 919.

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## VI. COURT'S RATIONALE

The Seventh Circuit began its analysis by stating the three circumstances under which federal law preempts state law: "(1) when the federal statute explicitly provides for preemption; (2) when Congress intended to occupy the field completely; and (3) where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."<sup>14</sup> Here, only the third option is pertinent because: (1) the Lanham Act does not contain a provision explicitly preempting punitive damages under pendent state law claims; and (2) it has been established that the Lanham Act "does not in general preclude state unfair competition statutes from operating," so Congress did not intend to exclusively occupy the field of trademark regulation.<sup>15</sup> Therefore, the issue was whether awards of punitive damages for unfair competition "stand 'as an obstacle to the accomplishment and execution of the full purposes and objectives'" of the Lanham Act.<sup>16</sup> Next, the court took a close look at the language of the statute. The Lanham Act's remedy scheme provides:

[T]he plaintiff shall be entitled . . . 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. . . . 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.*<sup>17</sup>

From the plain language of the statute, the rationale behind the Lanham Act's remedial scheme is evident: to compensate injury to the plaintiff, not to penalize the acts of the defendant. Punitive damages by their very nature constitute a penalty; therefore punitive damages are not an available remedy under the Lanham Act. But the court pointed out that nothing in the language of the Lanham Act expressly forbid punitive damage awards under state law claims, and the statute was not clear as to whether punitive damages would form "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."<sup>18</sup>

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14. *Id.* (internal quotation marks omitted).

15. *Attrezzi, LLC v. Maytag Corp.*, 436 F.3d 32, 41 (1st Cir. 2006).

16. *JCW Invs.*, 482 F.3d at 918.

17. *Id.* at 918 (quoting 15 U.S.C. § 1117(a) (2006)).

18. *Id.* (internal quotation marks omitted).

Subsequently the Seventh Circuit considered the approach taken by the First Circuit in an analogous case, *Attrezzi, LLC v. Maytag Corp.*, which also involved a question of preemption of state law remedies by the Lanham Act.<sup>19</sup> In the *Attrezzi* case, the plaintiff prevailed on claims of unfair competition brought under both state law and the Lanham Act. The First Circuit awarded the plaintiff attorneys' fees and double damages when the jury found the defendant had willfully infringed plaintiff's trademark.<sup>20</sup> New Hampshire law awards attorneys' fees to the plaintiff automatically and offers enhanced damages automatically upon a showing of a willful or knowing violation. In contrast, the Lanham Act allows for attorneys' fees only in "exceptional cases" and permits enhanced damages awarded in the court's discretion, "subject to principles of equity."<sup>21</sup> The defendant appealed, claiming that the Lanham Act should preempt the "deviating state rule" with regard to attorneys' fees and enhanced damages.<sup>22</sup>

In determining "whether New Hampshire's laxer standard for an award of attorneys' fees or its mandatory award of enhanced damages undermines the policy of the federal statute," the court pointed out that, although the remedial structure was more generous, the state law was substantively the same as the federal law.<sup>23</sup> Since "it is accepted that Congress did not prohibit state unfair competition statutes that might have *substantive* terms somewhat more favorable to plaintiffs than the Lanham Act," the court opined that "to complain in this case about the modest deviation in remedial benefits favorable to plaintiffs is to swallow the camel but strain at the gnat."<sup>24</sup> The First Circuit concluded that, because "state substantive regimes are (ordinarily) not preempted by the Lanham Act, neither is New Hampshire's tinkering with the remedial components."<sup>25</sup>

The Seventh Circuit applied the same line of reasoning used by the First Circuit in *Attrezzi* to the case at hand. Because the state substantive law (common law unfair competition) "survives and is coterminous with the federal law" (the Lanham Act) in the area of trademark regulation, the state law remedies should also survive.<sup>26</sup> The Seventh Circuit concluded, given that "the Lanham Act has not been interpreted as a statute with broad preemptive reach," if Congress had intended the Lanham Act to preempt the state law remedy of punitive damages, it would have clearly expressed it.<sup>27</sup>

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19. *Attrezzi*, 436 F.3d at 32.

20. *Id.* at 35-36.

21. *Id.* at 40 (quoting 15 U.S.C. § 1117(a) (2006)).

22. *Id.* at 41.

23. *Id.*

24. *Id.* at 42.

25. *Id.*

26. *JCW Invs., Inc. v. Novelty, Inc.*, 482 F.3d 910, 919 (7th Cir. 2007).

27. *Id.*

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## VII. CRITIQUE OF COURT'S APPROACH

At first blush, it does not seem fair that a plaintiff can bring a cause of action for trademark infringement under both state law and federal law and recover damages under both, including punitive damages under the state law claim even though the federal statute expressly bars such damages. This sounds like "double-dipping." Now, thanks to the Seventh Circuit's holding in *JCW Investments*, plaintiffs can easily circumvent the Lanham Act's limited remedies simply by tacking a state law claim onto their pleadings, praying for punitive damages, and citing this particular case.

### A. Purpose of Lanham Act

Under the test for federal preemption, the Seventh Circuit had to determine whether allowing state law remedies for punitive damages would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.<sup>28</sup> But surprisingly, the *JCW Investments* court did not discuss the purpose of the Lanham Act despite the view of another circuit court that:

Where conflict is alleged between federal and state law, the specific purpose of the federal act must be ascertained in order to assess any potential erosion of the federal plan by operation of the state law. The limited intent of Congress in enacting the Lanham Act is thus crucial to the discussion in the present case.<sup>29</sup>

In *Mariniello v. Shell Oil*, the Third Circuit examined the purpose of the Lanham Act and looked to the Senate report accompanying the Lanham Act:

The purpose underlying any trademark statute is twofold. One is to protect the public so it may be confident that . . . it will get the product which it asks for and wants to get. Secondly, where the owner of a trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats.<sup>30</sup>

The *Mariniello* court rejected the argument that Congress intended "comprehensively to control all aspects of the trademark field" and found that, "[d]espite the adoption of a uniform federal registration scheme, local trademarks may be enforced by statute or common law unless conflict develops with a national trademark."<sup>31</sup> The federal preemption rule stated in

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28. *Id.* at 918.

29. *Mariniello v. Shell Oil Co.*, 511 F.2d 853, 857-58 (3d Cir. 1975) (holding that Lanham Act did not preempt New Jersey common law protecting franchisees from termination of franchise agreement without just cause).

30. S. Rep. No. 79-1333, at 3 (1946), as reprinted in 1946 U.S.C.C.A.N. 1274, 1277.

31. *Mariniello*, 511 F.2d at 857-58.

*Mariniello* is that the Lanham Act does not preempt state laws regulating trademarks unless the “state law would permit confusing or deceptive trademarks to operate, infringing on the guarantee of exclusive use to federal trademark holders . . . .”<sup>32</sup> Under this analysis, Congress did not intend to occupy the entire field of trademarks, therefore leaving substantive state law intact so that states could regulate local trademarks. However, it does not follow that, by leaving intact substantive state law to regulate local trademarks, Congress intended plaintiffs to have recourse under both federal law and state law for the violation of a national trademark.

## B. Legislative History of Lanham Act

An examination of the legislative history can help a court to understand the purposes and objectives of Congress. However, in deciding *JCW Investments*, Justice Wood failed to mention any legislative history of the Lanham Act. In determining whether to allow punitive damages under a state law claim that mirrors a claim under the Lanham Act, a court should carefully consider Congress’s reasons for expressly denying that form of relief. The Second Circuit explored the legislative history of the Act in a case factually similar to the case at bar. In *Getty Petroleum Corp. v. Bartco Petroleum Corp.*, Getty Petroleum alleged infringement of their registered trademark in violation of the Lanham Trademark Act.<sup>33</sup> The plaintiff also brought a claim of unfair competition under the common law and asserted several theories of recovery under state law.<sup>34</sup> Before the issues reached the jury, however, Getty withdrew all claims except the one based on trademark infringement.<sup>35</sup> The jury returned a verdict in favor of Getty and awarded compensatory damages in the amount of \$107,579.75 and \$6.5 million total in punitive damages.<sup>36</sup> Due to the fact that a \$6.5 million judgment was “so high as to shock the judicial conscience” of the court, the district court held a new jury trial solely on the issue of punitive damages.<sup>37</sup> That jury awarded punitive damages of over \$2 million.<sup>38</sup> On appeal, the Second Circuit did not address Getty’s argument that “the jury’s punitive damage award could be justified under a common law unfair competition theory and its state law claims.”<sup>39</sup> Because the jury’s special verdict form did not include unfair competition issues for the jury to decide, “the sole basis for awarding punitive damages

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32. *Id.* at 858.

33. *Getty Petroleum Corp. v. Bartco Petroleum Corp.*, 858 F.2d 103, 105 (2d Cir. 1988), *cert. denied*, 490 U.S. 1006 (1989).

34. *Id.*

35. *Id.* at 106.

36. *Id.* at 105.

37. *Id.* at 106 (quoting *Zarcone v. Perry*, 572 F.2d 52, 56 (2d Cir. 1978)).

38. *Id.*

39. *Id.*

was appellants' willful infringement of Getty Petroleum's trademark rights."<sup>40</sup> As such, the issue became whether section 35 of the Lanham Act permits imposing punitive damages against a trademark infringer.<sup>41</sup>

The Second Circuit began its examination of the legislative history of the Lanham Act's remedial provision with a discussion of its predecessor, the Trademark Act of 1905:<sup>42</sup>

[Section] 35 of the Lanham Act, currently 15 U.S.C. § 1117(a), incorporated [section] 16 from the 1905 Act, 33 Stat. 729 (remedy at law for registered trademark infringement), as well as [section] 19, 33 Stat. 729 (remedy in equity). Both [section] 16 and [section] 19 gave the district court discretion to increase an award of actual damages up to three times its amount. . . . Section 35 of the Lanham Act echoes these earlier recovery provisions. Significantly, neither [section] 16 nor [section] 19 contained provisions for punitive damages.<sup>43</sup>

The court also pointed out that the provision for discretionary treble damages in the 1905 Act "was included to enable court to redress fully plaintiffs whose actual damages were difficult to prove."<sup>44</sup> Concluding its review of the 1905 Act, the court stated that "the 1905 Act's language, history, and judicial construction give no affirmative indication that when Congress enacted [section] 35 of the Lanham Act – basing its recovery scheme in part on the 1905 Act – it aimed to furnish punitive damages as a remedy."<sup>45</sup>

Next the court examined one of the significant additions the drafters of section 35 made to the Lanham Act: the "caveat that a court's enhancement of a damage award or adjustment of profits awarded 'shall constitute compensation and not a penalty.'"<sup>46</sup> The court pointed to several statements made at subcommittee hearings to show the drafters' fear of unlimited recoveries by infringed trademark holders and their desire to limit recoveries strictly to compensation.<sup>47</sup> In conclusion, the Second Circuit held that "[section] 35 of the Lanham Act does not authorize an additional award of punitive damages for willful infringement of a registered trademark. So long as its purpose is to compensate a plaintiff for its actual injuries –even though

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40. *Id.* at 107.

41. *Id.* at 105.

42. *Id.* at 110.

43. *Id.* at 109.

44. *Id.* at 110.

45. *Id.*

46. *Id.*

47. *See id.* at 111.

the award is designed to deter wrongful conduct – the Lanham Act remains remedial.”<sup>48</sup>

Following the reasoning in *Getty Petroleum*, if the legislative history supports the conclusion that the purpose of the Lanham Act is purely remedial, then allowing recovery of punitive damages for state law claims would undermine Congress’s purpose – by punishing trademark infringers instead of compensating the injury to trademark holders. Congress forbade the recovery of punitive damages for a specific reason, and a judicial ruling that allows punitive damages under a state law claim that mirrors the Lanham Act will only subvert the authority of the legislature.

### C. Attorneys’ Fees Distinguishable from Punitive Damages

The Seventh Circuit’s holding relied on the reasoning used by the First Circuit in *Attrezzi*.<sup>49</sup> However, the *Attrezzi* case is distinguishable from *JCW Investments*, and the Seventh Circuit made a mistake by attempting to use the same logic. In *Attrezzi*, the issue was “whether New Hampshire’s laxer standard for an award of attorneys’ fees or its mandatory award of enhanced damages undermines the policy of the [Lanham Act] . . . .”<sup>50</sup> Unlike punitive damages, attorneys’ fees and enhanced damages are available remedies under section 35 of the Lanham Act.<sup>51</sup> The Lanham Act provides for the prevailing party to recover attorneys’ fees in “exceptional cases”<sup>52</sup> and allows for treble damages, at the judge’s discretion, subject to the principles of equity.<sup>53</sup> Therefore, the New Hampshire statute at issue in *Attrezzi*, which provided attorneys’ fees and enhanced damages automatically upon a showing of a willful or knowing violation, did not conflict with the purpose of the Lanham Act’s remedy provision. In response to a U.S. Supreme Court ruling denying attorneys’ fees under the Lanham Act,<sup>54</sup> Congress amended the Lanham Act in 1975 to add a provision that allowed courts to award attorneys’ fees.<sup>55</sup> The New Hampshire law merely provided a “laxer standard” than the Lanham Act, whereas the Illinois law provided a remedy that was expressly forbidden under the Lanham Act. These cases are distinguishable, and the Seventh Circuit erred in applying the same logic.

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48. *Id.* at 113.

49. *JCW Invs., Inc. v. Novelty, Inc.*, 482 F.3d 910, 919 (7th Cir. 2007).

50. *Attrezzi, LLC v. Maytag Corp.*, 436 F.3d 32, 41 (1st Cir. 2006).

51. *See* 15 U.S.C. § 1117(a)-(d) (2006).

52. *Id.* § 1117(a).

53. *Id.*

54. *See Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 721 (1967).

55. Act of Jan. 2, 1975, Pub. L. No. 93-600, § 3, 88 Stat. 1955 (codified as amended at 15 U.S.C. § 1117(a) (2006)).

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### VIII. CONCLUSION

In conclusion, the Seventh Circuit's holding in *JCW Investments*, allowing a plaintiff to recover punitive damages on a claim for trademark infringement brought under both state and federal laws, will only undermine the Congressional purpose of the Lanham Act. If the Seventh Circuit had closely examined the legislative history and the purpose of the Lanham Act, it would have realized that its holding undermines the policy of the federal statute. The Lanham Act should preempt state law remedies in so far as they are contrary to the purposes of the Act. Considering the lack of deference to the purpose and legislative history of the Lanham act and the fact that attorneys' fees are distinguishable from punitive damages, it would not be surprising to see *JCW Investments* overturned.