

THE DETERMINATION OF PROFITS IN PATENT INFRINGEMENT CASES

by

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Introduction

The Canadian Patent Act states that any person who infringes a patent is liable to the patentee for all damages sustained by the patentee by reason of the infringement.

The remedy for damages, so stipulated in the Act, may be categorized as a legal one. When one invokes the legal remedy of damages, the Court will seek to allow the Plaintiff to make good on its loss. As such, damages are only awarded for proven loss and the usual burden of proof lies with Plaintiff.

Equitable remedies have a different basis. An equitable recourse is normally invoked against the Defendant who has illegally received and withheld property belonging to Plaintiff, and has made profits from same. In such cases, Defendant is ordered to restore the property or the profits. Thus, contrary to a recourse for damages, in equity it is Defendant's gain which is determined and not Plaintiff's proven loss.

Adoption of remedy for profits in Canadian Patent Law

The Patent Act does not provide for the equitable remedy for profits. However, the remedy has been granted on at least three occasions by the Federal Court of Canada in patent infringement actions in the last ten years, and will more than likely grow in popularity given the higher awards usually associated with it. Those cases are: Teledyne Industries Inc. -vs- Lido Industrial

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Products, (1982) 68 C.P.R. (2d) 204 (F.C.T.D.), Ductmate Industries Inc. -vs- Exanno Products Ltd., (1986) 13 C.P.R. (3d) 193 (F.C.T.D.) and Diversified Products Corporation -vs- Tye-Sil Corporation Limited, (1990) 32 C.P.R. (3d) 385 (F.C.T.D.) (on appeal).

It is important, therefore, to understand the workings of the remedy and its potential with respect to awards in patent infringement cases especially when Defendant is a manufacturer. After all, the award in the Teledyne case was in excess of \$500,000.00 and the award in the Diversified Products case was just under \$2,000,000.00.

Before allowing the remedy for profits in a patent infringement action, the Court must determine whether such a remedy is appropriate in the circumstances of the case. In deciding whether a Plaintiff is entitled to an accounting of profits, the Court must exercise its discretion since the remedy is discretionary in nature. As such, the corollary to the above is that equitable defences may be raised in contestation of a demand for profits.

Burden of proof of parties to an accounting

Once the Court has come to the conclusion that it ought to exercise its discretion in favour of allowing the Plaintiff to claim for profits, a different set of rules is applicable to the evidentiary aspects of the case.

Where an accounting of profits has been ordered, no onus whatsoever lies on the Plaintiff to establish those profits. All the Plaintiff has to demonstrate to the Court are the gross sales of the Defendant. Once the gross sales are demonstrated, the onus lies with the Defendant to prove such **bona fides** expenses or disbursements as he can, by positive evidence, establish as having been actually incurred.

Accounting methods available to the Court

In addition to this disadvantage with respect to the burden of proof, the Defendant must face-up to the accounting practise that has been adopted in the Teledyne and the Diversified Products cases cited above. These two cases have adopted the "differential" method of accounting. The Defendant will usually attempt to demonstrate that the "full absorption cost" method ought to be applied. This latter method of accounting allows the Defendant to deduct such part of all its fixed costs as might be attributable proportionately to the infringing operation.

The differential accounting method on the other hand, allows only for the deduction from the revenue derived from sales of the infringing product, the variable expenses attributable to the product in question, and any increase in fixed expenses attributable to those infringing products. The Teledyne and the Diversified Products cases have, therefore, confirmed that when the differential accounting method is used, the infringer is entitled to deduct only those expenses, both variable and fixed, which actually contributed to the sums received and for which the infringer is liable to account. No part or proportion of any expenditure which would have been incurred had the infringing operation not taken place, is to be considered as deductible.

Under this method, "direct costs" are costs that can be directly tied to a specific unit of production or with a specific activity required solely for the manufacture and sale of the infringing product. "Common costs", otherwise known as indirect costs, are costs incurred for the benefit of two or more products or services. These costs are generally not deducted in calculating net profit when using a differential method of accounting, except for particular items of common costs that can be shown to have increased specifically for the production and sale of the infringing product. In such cases an allocation of a pro-rated portion of the common costs may be deducted from revenue to calculate net profit.

It may well be that in certain cases, the full absorption cost method of accounting is more appropriate than that invoked by the Federal Court, thus far, of differential accounting. In effect, the decision to invoke one or the other methods of accounting should depend on the situation of the Defendant at the time the decision to commence the manufacture or sale of the infringing product was taken.

Criteria used by Court in choosing accounting method

It would seem particularly unfair to impose the differential accounting method on a Defendant when, for example, the Defendant was operating at full capacity at the time the decision to manufacture the infringing article was taken, and when the Defendant cannot be demonstrated to have been in bad faith. In the Diversified Products case, the Court stated that the differential approach is particularly appropriate when a prospective Defendant has excess production capacity such as unused warehouse space, under-used machinery or under-employed personnel. Under those circumstances, such a Defendant would find the manufacture and sale of an infringing product more profitable than would a Defendant who had to incur additional fixed costs before such manufacture and sale could take place. In summary, the Court stated that one could even speculate that a potential

infringer who is operating from a position of excess productive capacity and is in the same business as the Plaintiff, could afford to be more careless about potential infringement than could a manufacturer who is not in that position.

Two additional principles were set out in the Diversified Products case to the effect that if the Defendant can produce a product more profitably than the Plaintiff, then the Plaintiff is entitled to the whole of that profit and a Plaintiff is not required to accept a lesser amount than what it could have made itself.

It would appear from the Diversified Products case that the Defendant to an accounting must provide a convincing reason for the Court to refrain from using the differential accounting approach. As such, in all cases where an accounting of profits is claimed by the Plaintiff, proof should always be adduced by Defendant with respect to the status of the Defendant's business at the time that a decision to manufacture the infringing product was taken. This will enable the Court to decide as to whether the differential approach is the appropriate one in the circumstances.

Conclusion

The differential accounting approach will always be more lucrative for the Plaintiff in a patent infringement case, and punitive for the Defendant. In practise, it is often almost impossible for a Defendant manufacturer to fully meet its burden of proof with respect to the direct costs of its sales.

The definitions of common and direct costs as established in the above-mentioned reported cases, ought to suffice in demonstrating the difficulties facing a Defendant in a patent infringement action when the claim is for profits and the differential accounting approach has been accepted by the Court. As such, a Defendant in such a situation must be prepared to make its proof of expenses in minute detail through the services of a qualified expert. Of course, this task is rendered less onerous when the Defendant has in place a modern and efficient accounting system.

Finally, in all patent infringement cases where it is likely that Plaintiff will opt for profits over damages, Defendant should do all it can to avoid an accounting by putting forth as early on in the proceedings as possible, all facts which militate against any entitlement to the remedy for profits in favour of Plaintiff.

