Determining an account of profits for patent infringement in OOO Abbott

15/03/2016

IP & IT analysis: The Court of Appeal has ruled that a judge incorrectly applied the rules on apportionment and the offset of overheads when determining an account of profits for patent infringement. David Bowden, freelance independent consultant, speaks to Dr Paul England, senior associate at Taylor Wessing, Thomas St Quintin, barrister at Hogarth Chambers, and Graham Burnett-Hall, partner at Marks & Clerk Solicitors, about what lessons can be learned from this case.

Original news

OOO Abbott v Design & Display Ltd [2016] EWCA Civ 95, [2016] All ER (D) 243 (Feb)

The Court of Appeal, Civil Division, allowed an appeal against the quantification of an account of profits following an earlier finding that the defendant had infringed the claimants' patent for a snap-in insert that attached to shop display panels. The judge had erred in his approach to apportionment of the overall profit made by the defendant and had further erred in his assessment of the deduction of general overheads.

What happened when the case was first heard in the Patents County Court?

David Bowden (DB): Abbott brought a claim in the Patents County Court (as was) claiming infringement of its patent. Both Design & Display and Eureka Display disputed this and counterclaimed for revocation of the patent on the ground of obviousness. HHJ Birss J (as he was then) tried the claim and gave judgment on 30 May 2013 (see *OOO Abbott and another v Design & Display Ltd and another company* [2013] EWPCC 27, [2013] All ER (D) 358 (May). He found the patent valid and infringed.

What did the first instance judge decide on the account of profits claim?

DB: HHJ Hacon handed down his judgment on the account of profits on 4 September 2014 (see *OOO Abbott and another v Design & Display Ltd and another* [2014] EWHC 2924 (IPEC), [2014] All ER (D) 31 (Sep).

Judge Hacon had to rule on which costs could be deducted from Design & Display's gross profits. He had to apply the Court of Appeal ruling in *Hollister Inc v Medik Ostomy Supplies Ltd* [2012] EWCA Civ 1419, [2012] All ER (D) 114 (Nov). Design & Display submitted that:

- when it switched to making non-infringing inserts it made no difference to its sales figures
- as it would have received no less custom, there was no more business to be had by selling infringing inserts, and
- it did not have staff or machines standing idle ready to exploit other opportunities

Having adapted the principles from *Hollister* in a way he felt appropriate for the case before him, judge Hacon rejected all these submissions and ruled that Design & Display 'has not satisfied the evidential burden to show that it is entitled to make any of the deductions from gross profits claimed in its table'.

On what grounds was an appeal made and what did the Court of Appeal decide?

DB: Design & Display's appeal raised two main questions:

- whether it is liable for the whole of the profits made on the sale of panels sold together with infringing inserts, and
- whether it is entitled to set off any part of its general overheads against its gross profit

The Court of Appeal allowed the appeal.

Is the way in which profits should be calculated on an account clear enough? If not, how should it work?

Thomas St Quintin (TSQ): The Court of Appeal repeated the principles on which an account is based—this is that its only purpose is the prevention of unjust enrichment of the defendant, not to result in the punishment of the defendant, and not to compensate the claimant.

That principle provides a fundamental test against which the court can test the correctness of any conclusion it is asked to reach, or against which it can test the applicability of any argument it is asked to consider, but does not provide a great deal of practical assistance in approaching factual disputes in an account. Other parts of the Court of Appeal's judgment do, however, offer some practical assistance.

Graham Burnett-Hall (GB-H): At a high level, the principle can be stated simply enough—the patentee is entitled to recover from an infringer the profits actually derived from the infringement. Where the patent is so essential to the product or process in question that the product or process would not have existed at all, but for the infringement, the patentee is likely to be able to claim all the infringer's profits derived from the sale or use of the infringing product or process. The position becomes much more difficult when the patent only protects part of a product or process, where the overall product or process would still have been made or used, perhaps in some modified form. In such circumstances, some kind of apportionment is likely.

Is the position on convoyed goods and causation clear enough? If not, how should it be improved?

DB: Lewison LJ ruled:

'In my judgment the legal error that the judge made was to ask whether the sale of the panel plus insert would have happened separately rather than to ask himself how much of the profit on the sale was derived from the infringement. In a case in which the infringement does not 'drive' the sale it seems to me that it is wrong in principle to attribute the whole of the profit to the infringement. In particular it does not follow from the fact that the customer wanted a slat wall that incorporated an insert that the customer wanted a slat wall that incorporated the infringing insert. Mr Cuddigan argued that the infringing inserts and the slot were the 'very essence' of the incorporated and unincorporated panels. But the judge made no such finding, and his observations at [32] suggest the contrary.'

Lewison LJ ruled that the judge below should have apportioned the overall profit. He remitted the case to the IPEC and noted that at that remitted hearing 'the judge would not be precluded from finding as a fact that the infringing insert was the 'essential ingredient' of the incorporated panel'.

Dr Paul England (PE): The approach of the Court of Appeal which asks, did the infringing items drive the sale, as opposed to any non-infringing alternative, is helpful to understanding the law in this area. However, it may be difficult on the facts to illustrate that some or all customers were so driven, and the evidence in this case appears to be mixed. This makes the first instance judge's task on assessing the apportionment more difficult.

TSQ: The Court of Appeal provided some clarity and some useful guidance as to the circumstances in which revenue realised from the sale of convoyed goods, or from the sale of products into which the subject matter of the patent is incorporated, will contribute to the profits that a defendant must disgorge. Where an infringer had generated only revenue from arts that would not have existed without the infringement, or where the invention was an essential ingredient in the creation of the infringer's whole product, then all of that revenue would contribute to the profits. Conversely, therefore, if revenue was generated by the sale of arts that would have existed and been sold even if there was no infringement, and if the invention was not an essential ingredient in the creation or sale of those products, then the revenue generated from those activities would not form part of the calculation of the profits to be disgorged.

GB-H: A key point in the Court of Appeal's judgment is that it is not sufficient, in order for a patentee to be able to recover the infringer's profits made on the sale of convoyed goods, to show that the sale of the two goods went together. There has to be more. In particular, it has to be shown that the sale of the patented art 'drove' the sale of the other product. This will be a question of fact and one that may be difficult to establish.

Is it clear enough how potential deductions from overheads should be treated? If not, how should it work?

DB: In *Dart Industries Inc v Décor Corp Pty* [1993] HCA 54 (which was heavily referred to in the current case the High Court of Australia ruled that:

'In calculating an account of profits, the defendant may not deduct the opportunity cost, that is, the profit forgone on the alternative products. But there would be real inequity if a defendant were denied a deduction for the opportunity cost as well as being denied a deduction for the cost of the overheads which sustained the capacity that would have been utilised by an alternative product and that was in fact utilised by the infringing product. If both were denied, the defendant would be in a worse position than if it had made no use of the patented invention. The purpose of an account of profits is not to punish the defendant but to prevent its unjust enrichment.'

Lewison LJ said this boiled down to a simple question:

'[…] if the defendant had not infringed the patent would he have carried on a non-infringing business which would have been sustained by the overheads in fact used to sustain the infringement?'

Lewison LJ said '[…] all four conditions [mentioned in *Hollister*] will need to be fulfilled before an infringer is prevented from offsetting any overheads against the gross profits derived from the infringement'. The factors were:

- a defendant has surplus capacity
- the infringing activity was an additional line to an established business,
- the defendant's overheads have been increased as a result of the infringing activity, or
- its overheads would have been lower had it not engaged in that activity

He said the question is not dependant on whether the infringer is working to capacity or not. Rather the question is:

- whether the overheads would have been incurred anyway (even if the infringement had not occurred), and
- the sale of infringing products would not have been replaced by sale of non-infringing products

If these two criteria are met then an allowance for overheads will not be permitted.

Lewison LJ found on the facts as set out in the judgment below that the judge had fallen into error. He said that 'what matters is that if it had not been selling infringing products Design & Display would have used the self-same overheads in generating profits by lawful trading.'

PE: It may seem odd that an infringer is permitted to deduct overheads, when those overheads are exclusively owed to the infringing activity. But it is the nature of this remedy that the infringer must account for its profits from the infringement. Also, as the court notes, if general overheads could be recouped, the infringer would be in a better position than if it had conducted innocent activity in which these could not be recouped.

TSQ: The judge in the IPEC, when he adapted the principles from *Hollister* in a way he felt appropriate for the case before him, had combined the requirements that a defendant be working to capacity, with an alternative requirement that its overheads used for the infringing business would have otherwise been used for a non-infringing business. That led to him concluding that none of the overheads the defendant had incurred could be deducted from the revenue it had realised. The Court of Appeal interpreted *Hollister* in a different way, and indicated that working to capacity (whatever that might mean on the facts of any particular case) was not a threshold requirement before overheads could be deducted.

GB-H: Lewison LJ's focus on the two criteria listed above appears to have simplified the approach that will need to be taken in determining whether overheads can be deducted and that is to be welcomed. However, addressing those two criteria will still be very specific to the facts of each case and clear evidence will be required, especially from the infringer.

What will happen next with this case?

DB: Lewison LJ said that on the basis of the facts found by Judge Hacon that it was not possible for the Court of Appeal to be able to assess profits on the basis it had ruled. It therefore remitted the case back to IPEC for the account of profits inquiry to resume and for IPEC to assess those profits on the correct legal basis.

Are IPEC procedures too prescriptive to allow enough time/evidence for an account of profits/damages inquiry? (eg due to hearing, cost recovery, and evidence restrictions)?

PE: The emphasis in the IPEC is cost effective justice for smaller and less complex cases. This means that the procedures are designed to be more streamlined than those normally seen in the Patents Court, including necessary restraints on the amount of evidence that is to be submitted. However, the judge will be able to assess whether he already has sufficient evidence to make the assessment based on the direction of the Court of Appeal.

GB-H: It will be very interesting to see whether the IPEC holds that exceptional circumstances exist in this case, thereby permitting further evidence to be adduced. The IPEC procedure is intended to ensure that issues are clearly defined and that documents and evidence are only to be allowed insofar as they are really necessary to resolve the dispute. This keeps costs down but it would be counter-productive if the end result was that the court did not have the information it needed properly to resolve the dispute.

How will accounts of profits and damages inquiries be dealt with under the Unified Patent Court (UPC) system?

TSQ: Article 13 of the Enforcement Directive 2004/48/EC (the Enforcement Directive) is expressly referred to, as the basis on which financial remedies should be assessed, in Regulation (EU) 1260/2012 implementing enhanced cooperation in the area of the creation of unitary patent protection with regard to the applicable translation arrangements. The Enforcement Directive, art 13, which refers to 'Damages' was thought by Kitchin LJ in *Hollister* to encompass damages in a broad sense to cover both reimbursement of the right holder's lost profits (that is what English cases call 'damages') and the return of profits made by the infringer. He went on to hold that the English approach to an account of profits is consistent with the requirements of the Enforcement Directive.

Further, art 68(2) of the Agreement on a Unified Patent Court (UPC Agreement) provides that:

'The injured party shall, to the extent possible, be placed in the position it would have been in if no infringement had taken place. The infringer shall not benefit from the infringement. However, damages shall not be punitive.'

The second and third sentences of UPC Agreement, art 68 essentially describe an account of profits.

It seems quite likely to be the case that 'Damages', as that term is used in the 18th draft of the Rules of Procedure of the UPC (UPC Rules) encompasses the disgorgement of the profits made by an infringer from his acts of infringement. One difference that UPC Agreement, art 68(2) might require, is that a patentee's election at an early stage between damages and an account of profits may no longer be appropriate—it would seem more in keeping with that art for the patentee to be awarded the greater of its loss and the infringer's profits.

PE: The award of damages in the UPC is provided by UPC Agreement, art 68, while the UPC Rules, Ch 4 deals with 'Damages and Compensation' but there is no separate provision on account of profits inquiries. However, UPC Agreement, art 68 is closely based on the wording of the Enforcement Directive, art 13.

In the Enforcement Directive, art 13, like UPC Agreement, art 68, 'lost profits' and 'unfair profits' are not explicitly described as alternative factors to be considered in the calculation of damages. However, that they are intended to be alternatives is supported by the wording of the Recitals to the Enforcement Directive and this also prevents double recovery of damages.

To assist in calculating an appropriate account of profits, UPC Rule 141 deals with requests to lay open books and provides that an applicant for damages may also request:

'(c) a description of the information held by the unsuccessful party to which the applicant requests access, in particular documents relating to turnover and profits generated by the infringing products or regarding the extent of use of the infringing process as well as accounts and bank documents, and any related document concerning the infringement.'

As a court serving most of the European Member States, in cases of infringements over multiple countries, the challenge for the UPC in cases like *Design & Display v Abbott*, will be to establish its own rules on when it is suitable to apportion and deduct overheads.

Interviewed by David Bowden.

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