Dart Industries Inc v Décor Corporation Pty Ltd **[1993] HCA 54**

HIGH COURT OF AUSTRALIA

MASON CJ, DEANE, DAWSON, TOOHEY AND MCHUGH JJ

MASON CJ, DEANE, DAWSON AND TOOHEY JJ:

The appellant ("Dart") was the successful plaintiff in an action in the Supreme Court of Victoria against the respondents ("Decor" and "Rian") for infringement of a patent in respect of press button seals, or lids, used to seal plastic kitchen canisters.[1] Rian manufactured, with tooling provided by Decor, and Decor produced and sold, plastic kitchen canisters with the press button seals.

Dart having elected between damages and an account of profits, the trial judge, King J., ordered an account of profits by Decor and Rian. In giving directions, King J. dealt with two questions, the first of which falls to be determined upon this appeal and the second of which is raised in an application by Decor and Rian for special leave to cross-appeal. The first is whether any part of general overhead costs is allowable as a deduction to Decor or Rian in the determination of the profits made by them from the infringement. The second is whether Decor and Rian must account for profits arising from the manufacture and sale of the composite product, consisting of both the body of the canister and the press button seal, or merely for those profits attributable to the manufacture and sale of the press button seal alone, that being the patented invention.

King J. answered the first question by directing that costs categorized as general overhead costs, in the sense that no part of them can be shown by Decor or Rian to be directly attributable to the manufacture or sale of canisters incorporating the patented invention, should not be taken into account as a deduction from gross profits. He directed that only costs which are directly attributable to manufacture or sale of the infringing product should be taken into account.[2] In

[1] The patent infringement proceedings are reported in *Dart Industries Inc. v Decor Corporation Pty. Ltd.* (1988), 11 I.P.R. 385 and *Decor Corporation Pty. Ltd. v Dart Industries Inc.* (1988), 13 I.P.R. 385.
[2] *Dart Industries Inc. v Decor Corporation Pty. Ltd.* (1990), 20 I.P.R. 144, at p. 152.

answer to the second question, King J. directed that the profits for which Decor and Rian must account are the profits from the manufacture and sale of the complete canisters, including the press button seals.[3]

Upon appeal from the interlocutory orders made by King J., the Full Court of the Federal Court held that the first direction was in error and that Decor and Rian should be "at liberty to show that various categories of overhead costs contributed to the obtaining of the relevant profit, and to show how and in what proportion they should be allocated in the taking of the account of profits".[4] The Full Court upheld the second direction given by the trial judge.[5] Dart now appeals, pursuant to special leave, against the rejection by the Full Court of the first direction given by the trial judge and Decor and Rian seek special leave to cross-appeal against the second direction upheld by the Full Court.

Damages and an account of profits are alternative remedies.[6] An account of profits was a form of relief granted by equity whereas damages were originally a purely common law remedy.[7] As Windeyer J. pointed out in *Colbeam Palmer Ltd. v Stock Affiliates Pty. Ltd.*,[8] even now[9] an account of profits retains its equitable characteristics in that a defendant is made to account for, and is then stripped of, profits which it has dishonestly made by the infringement and which it would be unconscionable for it to retain. An account of profits is confined to profits actually made, its purpose being not to punish the defendant but to prevent its unjust enrichment.[10] The ordinary requirement of the principles of unjust enrichment that regard be paid to matters of substance rather than technical form[11] is applicable.

[3] ibid., at p. 154.
[4] *Decor Corporation Pty. Ltd. v Dart Industries Inc.* (1991), 33 F.C.R. 397, at pp. 405-406.
[5] ibid., at pp. 407-408.
[6] See *Neilson v Betts* (1871), L.R. 5 H.L. 1, at p. 22; *Lever v Goodwin* (1887), 36 Ch. D. 1, at p. 7; *Patents Act 1990 Cth*, s. 122(1).
[7] cf. Meagher, Gummow and Lehane, Equity: Doctrines and Remedies, 3rd ed. (1992), pp. 659-660.
[8] (1968) 122 C.L.R. 25, at p. 34.
[9] See *Patents Act 1952 Cth*, s. 118(1); *Patents Act 1990 Cth*, s. 122.
[10] *My Kinda Town Ltd. v Soll* [1983] RP.C. 15, at p. 55; *Potton Ltd. v Yorkclose Ltd.* (1989), 17 F.S.R. 11, at pp. 14, 15; *Sheldon v Metro-Goldwyn Pictures Corp.* (1940), 309 U.S. 390, at p. 399.
[11] See *Baltic Shipping Co. v Dillon* (1993), 176 C.L.R. 344, at p. 376.

But it is notoriously difficult in some cases, particularly cases involving the manufacture or sale of a range of products, to isolate those costs which are attributable to the infringement from those which are not so attributable.[12] Whilst it is accepted that mathematical exactitude is generally impossible, the exercise is one that must be undertaken, and some assistance may be derived from the principles and practices of commercial accounting.[13] Unfortunately, neither the Australian nor the English authorities contain any precise analysis of the problem.

Leplastrier & Co. Ltd. v Armstrong-Holland Ltd.[14] involved an account of profits arising from the manufacture and sale of concrete mixing machines in breach of a patent. Harvey C.J. in Eq. drew a distinction between the profits made from the manufacture and sale of the infringing machines, which were to be accounted for, and the profits of the business in connexion with the sale of those machines, which were not.[15] He expressed the view that the defendant bore the onus of establishing that the costs were incurred in the manufacture of the machines and observed:[16]

> Under no circumstances can he, in my opinion, deduct interest on his capital employed in the business. Under no circumstances can he claim any remuneration to himself, nor under any circumstances can he claim in my opinion any director's fees for carrying on the business. I have no desire at the present stage to say exactly what can be taken into account as the costs of manufacture. It is clear that costs of material can be taken; it is clear that costs of wages can be deducted. It is possible that other costs may be taken, but I think the test which is to be applied is that the only expenses which can be deducted are those which were solely referable to the manufacture of the machines. If, for instance, for the purpose of manufacturing these machines the defendant found it necessary to install a particular piece of machinery which was useful for making these machines and for nothing else, then it might be that depreciation of this machinery would be a proper item to allow him as part of his costs of manufacturing the machines; if his machinery is used partly for the purpose of making these machines and partly for the purpose of other machines it may be proper to allow him such depreciation for wear and tear on the value of his machinery as may be properly allocated to the work which has been done on the infringing machines as compared with the work done on other machines.

[12] See *Siddell v Vickers* (1892), 9 R.P.C. 152, at pp. 162-163; *My Kinda Town Ltd. v Soll* [1983] RP.C., at pp. 57-58.
[13] See *Odeon Associated Theatres Ltd. v Jones* [1973] Ch288, at pp. 294, 299, 305; *Federal Commissioner of Taxation v St. Hubert's Island Pty. Ltd. (In liq.)* (1978), 138 C.L.R. 210, at p. 228.
[14] (1926) 26 S.R. (N.S.W.) 585.
[15] ibid., at p. 591.
[16] ibid., at p. 593.

In giving the first direction, King J. relied upon this passage in the judgment of Harvey C.J. in Eq. and adopted the language of his Honour, saying that only costs which are "solely referable" to manufacture or sale of the infringing article may be deducted.[17]

Dart relies upon the same passage to support its submission that the correct accounting principle to employ in the taking of an account of profits is incremental costing rather than absorption costing. Incremental costing takes account only of the change in costs incurred by the manufacture or sale of a particular product and does not seek to apportion to the manufacture or sale of that product any part of general overheads, such as rent, light, heating or office expenses, which cannot be identified as a direct result of producing that product. Absorption costing on the other hand is a costing method whereby general overheads are apportioned by some appropriate means, often by sales or volume, to the manufacture or sale of each product.

Dart's argument, based on incremental costing as the proper method for taking an account of profits of infringing activities, is as follows. The profit should be calculated by taking the gross revenue received from the manufacture and sale of the infringing product and deducting from it direct costs, such as materials or labour, solely due to the manufacture or sale of the infringing product, and also deducting overheads, but only to the extent that they were increased by the manufacture or sale of the infringing product. Otherwise, the defendant would be able to deduct expenditure which it would have incurred in any event. This should not be allowed because if any of the revenue from the sale or manufacture could be set off against general overheads which would have been incurred without the infringing activities, the defendant would profit from the infringing activities. The defendant would gain by reducing the cost of its overheads, but would not have to account to the plaintiff for this gain.

Not only does Dart rely on the passage cited from the judgment of Harvey C.J. in Eq. but it maintains that the same principle is to be seen in the judgment of Windeyer J. in *Colbeam Palmer Ltd. v Stock Affiliates Pty. Ltd.* That was a case of infringement of a trade mark in which

[17] *Dart Industries Inc. v Decor Corporation Pty. Ltd.* (1990), 20 I.P.R., at p. 151.

Windeyer J. ordered an account of profits. In doing so, he directed that the cost of selling and delivering the infringing articles be taken into account. But he added:[18]

> This will include any costs directly attributable to such sales and deliveries. But it should not, I think, include any part of the general overhead costs, managerial expenses and so forth of the defendant's business, as it seems that all these would have been incurred in any event in the ordinary course of its business in which as it was put in evidence the painting sets were a "side line".

The explanation of the direction given by Windeyer J. is that mentioned by him, namely, that the infringing articles were a side line. There appears to have been unused capacity in the defendant's business in the form of overheads which would have been incurred whether or not the infringing articles had been sold and delivered. The sale and delivery of the infringing articles took up that surplus capacity or some of it, and none of the overhead costs was attributable to the infringing activities because those costs would have been incurred in any event.

But there was no evidence in this case that Decor or Rian had unused or surplus capacity. There was evidence that the infringing canisters were an integral part of one consistent product range produced, marketed and sold according to a common system. From this it might be inferred that, had those companies not been engaged in the manufacture and marketing of the infringing press button seal canisters, their capacity for those activities would have been taken up in the manufacture and marketing of alternative products.

Thus the cost of manufacturing and marketing the press button seal canisters may have included the cost of forgoing the profit from the manufacture and marketing of alternative products. The latter cost is called an opportunity cost. "Opportunity cost" can be defined as "the value of the alternative foregone by adopting a particular strategy or employing resources in a specific manner As used in economics, the opportunity cost of any designated alternative is the greatest net benefit lost by taking an alternative."[19] The practical reality of this concept was recognized in *Schnadig Corp. v Gaines Manufacturing Co. Inc.*,[20] where the Court stated: "The alternative

[18] (1968) 122 C.L.R., at p. 39.
[19] Kohler's Dictionary for Accountants, 6th ed. (1983), pp. 362-363.
[20] (1980) 620 F. 2d 1166, at p. 1175.

available uses of the facilities devoted to the infringement must be considered, and these too will vary."

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 utilized by an alternative product and that was in fact utilized 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.

Where the defendant has forgone the opportunity to manufacture and sell alternative products it will ordinarily be appropriate to attribute to the infringing product a proportion of those general overheads which would have sustained the opportunity. On the other hand, if no opportunity was forgone, and the overheads involved were costs which would have been incurred in any event, then it would not be appropriate to attribute the overheads to the infringing product. Otherwise the defendant would be in a better position than it would have been in if it had not infringed. It is not relevant that the product could not have been manufactured and sold without these overheads. Nor is it relevant that absorption method accounting would attribute a proportion of the overheads to the infringing product. The equitable principle of an account of profits is not to compensate the plaintiff, nor to fix a fair price for the infringing product, but to prevent the unjust enrichment of the defendant.

Of course, further possibilities may in some cases be open on the evidence. Overhead costs might have been increased by the manufacture and sale of the infringing product, or overhead costs might have been reduced had the infringing product not been produced. In either case it may be appropriate to attribute the difference in overhead costs to the infringing product.

It does not appear that in *Leplastrier & Co. Ltd. v Armstrong-Holland Ltd.* the concept of opportunity cost played any part in the reasoning of Harvey C.J. in Eq. In allowing the deduction only of expenses "solely referable" to the manufacture of the infringing product, he seems to have intended to exclude overheads except to the extent that they were increased by the manufacture of the infringing product. The examples that he gave indicate such an approach. But this is hardly surprising since the English authorities, even the more recent ones, have not grappled with the concept. Whilst they recognize[21] that the purpose of ordering an account of profits is not to inflict punishment, but is limited to compelling the defendant to surrender profits improperly made, there is little examination of the principles to be employed in ascertaining which profits were derived from the infringement.[22]

In the United States the position is otherwise. It was early recognized in The Tremolo Patent[23] that in the ascertainment of profits arising from the infringement of a patented tremolo attachment to musical instruments, an apportionment of general overheads was required. Strong J. in delivering the judgment of the Supreme Court said:[24]

> We cannot see why the general expenses incurred by the defendants in carrying on their business, such expenses as store rent, clerk hire, fuel, gas, porterage, &c., do not concern one part of their business as much as another. It may be said that the selling [of] a tremolo attachment did not add to their expenses, and therefore that no part of those expenses should be deducted from the price obtained for such an attachment. This is, however, but a partial view. The store rent, the clerk hire, &c., may, it is true, have been the same, if that single attachment had never been bought or sold. So it is true that the general expenses of their business would have been the same, if instead of buying and selling 100 organs, they had bought and sold only ninety-nine. But will it be contended that because buying and selling an additional organ involved no increase of the general expenses, the price obtained for that organ above the price paid was all profit? If, therefore, in estimating profits, every part is not chargeable with a proportionate share of the expenses, no part can be. But such a result would be an injustice that no one would defend.

Employing a similar line of reasoning, Decor and Rian contend that in an account of profits, if overheads are disregarded save to the extent that they were increased by the manufacture of the infringing product, then in a case where every product produced by a defendant infringed a patent, there would be no allowance at all for overheads, even though they would clearly be expenses incurred by the defendant in making the total profit from all the infringements.[25] Such a result is, they contend, unacceptable and indicates that a proper allowance for general overheads should be made.

[21] See My Kinda Town Ltd. v. Soll, [1983] R.P.C., at p. 55.
[22] See, e.g., *Crosley v Derby Gas-Light Co.* (1838), 3 My. & Cr. 428 [40 E.R. 992]; *Peter Pan Manufacturing Corp. v Corsets Silhouette Ltd.* [1963] RP.C. 45, at pp. 59-60; *My Kinda Town Ltd. v Soll* [1983] RP.C. 15; *Potton Ltd. v Yorkclose Ltd.* (1989), 17 F.S.R. 11.
[23] (1874) 90 U.S. 518.
[24] ibid., at pp. 528-529.
[25] cf. the example given by Hodgson J. in *E. I. Du Pont de Nemours & Co. v Commissioner of Patents [No. 3]* (1989), 15 I.P.R. 296, at p. 307.

Some caution is to be exercised in the use of United States authorities dealing with accounts of profits because, in some instances, both damages and an account of profits are available, and because a distinction is drawn between wilful and non-wilful infringement which may affect the profits recoverable. Moreover, the approach adopted in the cases varies to some extent. But it is clear enough that the guiding principle in the United States, as here, is that an account of profits aims to have the defendant account for the actual profit, no more and no less, which it has gained from the infringement.

In *Levin Bros. v Davis Manufacturing Co.*,[26] which was a patent infringement case, the Eighth Circuit Court of Appeals upheld a ruling which disallowed any deduction for fixed costs — that is, costs already incurred for plant and the like which did not vary with the volume of production — in determining the profits made from the infringement. But the Court made it clear that it was laying down no invariable rule:[27]

> The patent law gives the right to recover all profits from an infringement. "Profit", as so used, is no mysterious phrase. It means simply all financial gains. Such gains are the difference between expenditures made to produce and sell the infringing articles and the receipts therefrom. Obviously, the application of this rule — the ascertainment of such actual profits — will occasion separate accounting and fact problems in each case because items entering into cost or into receipts will differ. Always, however, the task is to see that the patentee recover every dollar of advantage realized by the infringer from the infringement and no more. No fast and hard rules should or can be stated to guide application of this general rule to the infinite variety of fact situations developed in different cases. Because a recurring item, like overhead, is handled a certain way in a given case such is no statement of a rule of law that the same item must be similarly dealt with in all cases. The "rules" contended for by the parties here are not rules of law. They are but illustrations of applications of the above single broad rule to different fact situations.

The Court went on to observe:[28]

> It often happens that overhead expenses are applicable to and should be spread over the entire business but where a business is established and in operation and another line is taken on without increase of overhead expenses it is just to the patentee that the actual situation be applied and none of such overhead be charged as an expense of the added line except as it participated in manufacture or sale of the infringing article.

[26] (1934) 72 F. 2d 163.
[27] ibid., at p. 165.
[28] (1934) 72 F. 2d, at p. 166.

Not surprisingly, *Levin Bros. v Davis Manufacturing Co.* has been relied upon in the United States as an authority both for and against the deduction of overheads in an account of profits.[29] But that decision accepted the view, in our opinion correctly, that in some cases profit can only be properly assessed by deducting a proportion of at least some of the overheads, including fixed costs. The overheads, if any, to be deducted and the basis of apportionment will depend upon the facts of each case, bearing in mind always that the aim of the exercise is to arrive as closely as possible at the true profit.

The basis of apportionment may vary from case to case. Thus in *Sheldon v Metro-Goldwyn Pictures Corp.*[30] the Supreme Court of the United States upheld the decision of the Second Circuit Court of Appeals allowing the apportionment of overheads in the computation of profits. The Supreme Court said[31] that the questions involved were questions of fact which had been determined on the evidence. In that case the production of a motion picture infringed copyright. The Second Circuit Court of Appeals allowed the allocation of overheads between the infringing movie and other movies upon the basis of the cost of production. It observed that it was "more likely that a given picture required that proportion of the general services represented by its cost of production, than that each picture shared those services equally".[32]

Sheldon v Metro-Goldwyn Pictures Corp. may be contrasted with *Wilkie v Santly Bros. Inc.*[33] in which there was infringement of copyright in a song. The music publisher's overheads were allocated upon the basis of the number of songs published within a given period, without regard to the number of copies sold of each song, because the publisher was unlikely to incur a greater proportion of overheads for a hit song than for other published songs.

[29] *Schnadig Corp. v Gaines Manufacturing Co. Inc.* (1980), 620 F. 2d, at p. 1174; cf. *Sheldon v Metro-Goldwyn Pictures Corp.* (1939), 106 F. 2d 45, at p. 54; *Alfred Bell & Co. Ltd. v Catalda Fine Arts Inc.* (1949), 86 F. Supp. 399, at p. 415; with *Carter Products Inc. v Colgate-Palmolive Co.* (1963), 214 F. Supp. 383, at p. 403.
[30] (1940) 309 U.S. 390.
[31] ibid., at p. 409.
[32] (1939) 106 F. 2d, at p. 52.
[33] (1943) 139 F. 2d 264.

The guiding principle would seem to be that the onus is on the infringer to provide a reasonably acceptable basis for allocation.[34] This may be the basis of allocation typically used by a manufacturer in that industry.

In *My Kinda Town Ltd. v Soll*[35], Slade J. was inclined to think that in the taking of an account of profits the onus of proof fell upon neither party. As we have said, a different view was taken by Harvey C.J. in Eq. in *Leplastrier & Co. Ltd. v Armstrong-Holland Ltd.*[36] where he expressed the opinion that the onus is on the defendant to establish that any item of costs was incurred in relation to the manufacture of the infringing articles. The view of Harvey C.J. in Eq. would seem to be the preferable one, at least so far as it requires that the defendant establish that the overheads in any particular category are attributable to the manufacture or sale of the infringing product. It is a view which is supported by the United States authorities[37] and may also be justified because the relevant facts are likely to be peculiarly within the knowledge of the defendant.

In the present case, the trial judge accepted that the manufacture and sale of the infringing goods was not a side line. He found that Decor's range of canisters with press button seals formed part of a much larger range of container systems, storage systems and canisters.[38] On the evidence, the share of sales of the canisters with press button seals varied from 3.1 per cent to 1.3 per cent over a six-year period after they were added to Decor's existing range, and that percentage was similar to the percentage of sales of other types of containers in Decor's range.

Decor contends that it is possible to identify some overheads as direct costs which may be attributed to the press button seal canisters as actually incurred in respect of them, namely, the cost of product development/royalty expenses, media advertising, industrial design registration, legal fees and tooling expenses. It seeks to allocate all remaining overheads which

[34] See *Frank Music Corp. v Metro-Goldwyn-Mayer Inc.* (1985), 772 F. 2d 505, at p. 516.
[35] [1983] R.P.C., at p. 57.
[36] (1926) 26 S.R. (N.S.W.), at p. 593.
[37] See, e.g., *Westinghouse Electric & Manufacturing Co. v Wagner Electric & Manufacturing Co.* (1912), 225 U.S. 604, at pp. 620-622; *Duplate Corp. v Triplex Safety Glass Co.* (1936), 298 U.S. 448, at p. 458.
[38] (1990) 20 I.P.R., at p. 152.

are indirect costs by reference to the proportion which sales of canisters with press button seals bear to total sales.

Whether Decor and Rian should succeed in their contentions depends upon whether, as a matter of fact and substance, the overheads which they seek to have deducted are attributable to the manufacture and sale of the infringing product. In arriving at an answer, the Court must consider such questions as whether the overheads in any particular category were increased by the manufacture or sale of the product, whether they represent costs which would have been reduced or would have been incurred in any event, and whether they were surplus capacity or would, in the absence of the infringing product, have been used in the manufacture or sale of other products. Dealing with the last of these questions may require the use of the concept of opportunity cost. If any of the categories are to be brought into account, the proportion to be allocated to the infringing product must be determined and it is here that approximation rather than precision may be necessary. But such an approach has long been accepted. As was said in *Colburn v Simms*:[39]

> The Court, by the account, as the nearest approximation which it can make to justice, takes from the wrongdoer all the profits he has made by his piracy, and gives them to the party who has been wronged.

It follows that we consider that King J. was in error in directing that "no part of general overhead costs is allowable as a deduction" and that the Full Court was substantially correct in directing, as it did, that "the appellants are at liberty to show that various categories of overhead contributed to the obtaining of the relevant profit, and to show how and in what proportion they should be allocated in the taking of the account of profits". But it would be better, we think, if the word "contributed" were replaced by the words "are attributable".

The application by Decor and Rian for special leave to cross-appeal may be dealt with more shortly. In considering whether the profits for which an account was ordered should include those arising from the manufacture and sale of the canisters as well as the press button seals which were fitted to them, the trial judge correctly identified the problem when he said:[40]

[39] (1843) 2 Hare 543, at p. 560 [67 E.R. 224, at p. 231].
[40] (1990) 20 I.P.R., at p. 152.

> The basic legal principle is that the relevant profits are those accruing to the defendants from their use and exercise of the plaintiff's patented invention. Where the defendants' products are, as here, composites of the invention and other features the determination of such a question is one of fact.

In answering the question which he posed, King J. found that "sales of press button canisters are for present purposes attributable to use of the patented invention" and for that reason directed that the profits for which Decor and Rian had to account included the profits from the containers to which the press button seals were fitted.[41]

The Full Court identified the same question in somewhat different terms:[42]

> The respondent cannot gainsay that it is only entitled to the profits obtained by the infringement. If, for example, a patented brake is wrongfully used in the construction of a motor car, the patentee is not entitled to the entire profits earned by sales of the motor car. He must accept an appropriate apportionment. But the question is how that principle shall be applied to a situation where the patent relates to the essential feature of a single item. it seems to us that it was open to the judge to find, and he correctly found, that what characterised the infringing product was the press button lid, without which this particular container would never have been produced at all.

The questions posed by the trial judge and the Full Court concerning the apportionment of a total profit both accurately reflect the correct principle which was expressed in this Court by Windeyer J. in *Colbeam Palmer Ltd. v Stock Affiliates Pty. Ltd.* as follows:[43]

> The true rule, I consider, is that a person who wrongly uses another man's industrial property — patent, copyright, trade mark — is accountable for any profits which he makes which are attributable to his use of the property which was not his.
>
> If one man makes profits by the use or sale of some thing, and that whole thing came into existence by reason of his wrongful use of another man's property in a patent, design or copyright, the difficulty disappears and the case is then, generally speaking, simple. In such a case the infringer must account for all the profits which he thus made.

It is true that there is some divergence between King J. and the Full Court in relation to whether, in the circumstances of this case, primary emphasis should be placed on reason for sale or reason for production. Nonetheless, the overall approach of both accurately reflects the application of the correct general principle in the resolution of what is ultimately a question of fact.

[41] ibid., at p. 154.
[42] (1991) 33 F.C.R., at p. 407.
[43] (1968) 122 C.L.R., at pp. 42-43.

It follows from what has been said above that, if special leave were granted, the cross-appeal would necessarily turn upon a question of fact upon which there are concurrent findings by the trial judge and the Full Court against Decor and Rian. It would for that reason be inappropriate to grant special leave to cross-appeal.[44]

For these reasons we would dismiss the appeal and refuse special leave to cross-appeal.

MCHUGH J:

Two questions arise in this appeal against an order of the Full Court of the Federal Court made in an action arising out of the infringement of a patent. First, is any part of an infringer's general overheads deductible in the taking of an account of profits ordered as the result of the infringement? Second, if it is, what is the principle or rule which determines what proportion of the overheads is allocated to the infringing product?

The appellant is Dart Industries Inc. ("Dart") which is the licensee of a patent for an invention called "three-part press type seal" (or "lid"). When the lid is fitted to a container, the resulting product is commonly referred to as a press button seal canister. The Decor Corporation Pty. Ltd. ("Decor"), the first respondent, designs and markets, but does not manufacture, plastic homeware and gardenware. Decor markets over 400 products. Every aspect of its business is linked, and, according to one witness, is highly integrated. Decor's manufacturing needs are met by sub-contractors, one of whom was Rian Tooling Industries Pty. Ltd. ("Rian"), the second respondent. In the Supreme Court of Victoria, King J. held that a plastic closure fitted to a container which was manufactured by Rian and marketed by Decor infringed Dart's patent.

Pursuant to the provisions of the *Patents Act 1952 Cth*, Dart elected to take an account of profits in respect of the infringement. King J. ordered that only costs directly attributable to obtaining, holding, manufacturing, storing, selling and delivering the infringing product could be included in the account. The Full Court of the Federal Court set aside that order. The Full Court ordered

[44] See *Baffsky v Brewis* (1976), 51 A.L.J.R. 170, at p. 172; 12 A.L.R. 435, at p. 438; *The Commonwealth v Introvigne* (1982), 150 C.L.R. 258, at pp. 262, 274; *Muschinski v Dodds* (1985), 160 C.L.R. 583, at p. 590.

that the respondents "are at liberty to show that overheads falling within the various categories of overhead contributed to the obtaining of the relevant profit and to show how and in what proportion such overheads should be allocated in the taking of the account of profits".

Decor's list of general overheads includes the expenses involved in operating its bulk storage warehouse and other expenses, such as accounting and auditing, cartage and wharfage, light and power, overseas representation, printing, stationery and photocopying and seminar/training expenses, bank charges, rates and taxes, rent and superannuation. A proportion of the total overhead is allocated to the cost of each product in Decor's range. Allocation is made on the basis of sales to total sales. Given the nature of Decor's business, it is impossible to directly trace the incurring of the overhead to any particular product. Conversely, Decor allocates sundry income items (such as discounts received, export grants, interest received and others) to each product in its range. Rian's overheads include electricity, delivery and cartage, insurance, rent, rates, lease expenses, factory supervisors' wages and the cost of industrial waste removal.

Are general overheads deductible in an account of profits for a patent infringement?

Dart contends that, in taking an account of profits resulting from a patent infringement, no deduction is allowable for any expenditure "which would have been incurred had infringing manufacture not taken place". It contends that only two categories of costs can be deducted from gross revenue. First, direct costs "solely due" to the manufacture and sale of the product. Second, overheads to the extent that they have been increased by the manufacture and sale of the product. Decor and Rian, on the other hand, contend that all general overheads which assist or contribute to the production or sale of the infringing product are deductible.

In my opinion, the correct rule is that, in determining an account of profits in respect of the infringement of a patent, any part of the general overheads of the infringer which assisted in deriving gross revenue from the infringing product is a deductible expense. By general overheads, I mean "those general charges or expenses, collectively, in any business which cannot be charged up as belonging exclusively to any particular part of the work or product

[such] as rent, taxes, insurance, lighting, heating, accounting and other office expenses".[45] An expense may be deductible, therefore, although it did not directly increase the cost of producing or distributing the infringing product.

A plaintiff who establishes an infringement of its patent is entitled to an order that the infringer account for the profits derived from the infringement.[46] The object of an account of profits is to make the infringer give up its gains in order to prevent its unjust enrichment.[47] No element of punishment is involved.[48] If an infringer has expended its own money or resources in producing or distributing the infringing product, it is not unjust for it to recoup that expenditure before accounting for the revenue derived from the product. With that general proposition, Dart agrees. But it contends that the case is different when the expenditure would have been incurred "in any event". If the infringer can claim the cost of expenditure which would have been incurred in any event, Dart contends that the infringer will have profited from its wrong. This argument has a certain plausibility. But the answer to it lies in the concept of opportunity cost.

"Opportunity cost" can be defined as "the value of the alternative foregone by adopting a particular strategy or employing resources in a specific manner [I]n economics, the opportunity cost of any designated alternative is the greatest net benefit lost by taking an alternative".[49] The relevance of the concept of opportunity cost in an infringement action was recognized in *Schnadig Corp. v Gaines Manufacturing Co. Inc.*,[50] where the Court of Appeals for the Sixth Circuit said: "The alternative available uses of the facilities devoted to the infringement must be considered, and these too will vary."[51]

[45] Webster's New International Dictionary, 2nd ed. unabridged, cited in *Sammons v Colonial Press* (1942), 126 F. 2d 341, at pp. 350-351 and *Alfred Bell & Co. v Catalda Fine Arts* (1949), 86 F. Supp. 399, at p. 415.
[46] *Patents Act 1952*, s. 118(1); *Patents Act 1990*, s. 122; *Cartier v Carlile* (1862), 31 Beav. 292 [54 E.R. 1151]; *Colbeam Palmer Ltd. v Stock Affiliates Pty. Ltd.* (1968), 122 C.L.R. 25, at p. 43.
[47] *Potton Ltd. v Yorkclose Ltd.* (1989), 17 F.S.R. 11, at p. 15.
[48] *Sheldon v Metro-Goldwyn Pictures Corp.* (1940), 309 U.S. 390, at p. 399; *My Kinda Town Ltd. v Soll* [1983] RP.C. 15, at p. 55; *Potton* (1989), 17 F.S.R., at p. 15.
[49] Kohler's Dictionary for Accountants, 6th ed. (1983), pp. 362-363.
[50] (1980) 620 F. 2d 1166, at p. 1175.
[51] The concept of opportunity cost was also recognized by this Court, although in a different context to the present case, in *Hungerfords v Walker* (1989), 171 C.L.R. 125, at p. 143.

To say that general overhead would have been incurred "in any event", does not necessarily lead to the conclusion, as Dart asserted, that the respondents will profit from their wrong if an allowance is made for that overhead. If a preferred product cannot be produced or distributed (because, for example, it infringes property rights), a rational entrepreneur will choose the next best alternative. General overheads will then be partially absorbed in the cost of the substitute product.[52] If the infringing product had not been produced or sold, Decor, as a rational entrepreneur, would have sought the next best alternative for its resources. Thus, it might have produced another line of goods or more of its existing lines. Whatever the next best alternative may have been, that alternative, once adopted, would have absorbed part of the general overheads. Consequently, in so far as general overhead or costs that would have been incurred "in any event" assisted in the production or distribution of the infringing product, they form a relevant cost of that product. In the event that the next best alternative to producing the infringing product was to produce nothing, Decor still had the option of reducing some of its overheads.

If Dart's contention was accepted, general overhead could not form part of the cost of the infringing product for the purpose of an account of profits. By definition, general overhead is that part of the cost of running a business which cannot be allocated to any specific product. Consequently, overhead would not be relevant in determining what profit, if any, the infringer had derived from producing or selling the product. Yet no business can be profitable if its revenues fail to recoup its general overhead as well as the direct cost of selling its products. That being so, no product can generate a profit unless its selling price recoups both the direct costs of its production and distribution and its proportionate cost of the general overhead. Overhead is part of the cost of producing any product. As the United States Court of Appeals, Sixth Circuit, pointed out in *Schnadig*:[53] "The basic truth that no article of manufacture can be profitable in a real sense if it cannot bear its proportionate share of the fixed costs is hardly new." Adoption of Dart's contention might often lead to the conclusion that the infringer had profited when commercially no profit had been made. Certainly, adoption of Dart's contention would lead to an inflated statement of profit.

[52] Depending upon the circumstances, however, the absorption may not be as great as in the case where the product first chosen is capable of being added to the range.
[53] (1980) 620 F. 2d, at p. 1172.

To ignore overheads in the taking of an account of profits can also lead to absurd and unjust results. If all the products of a defendant were infringing products, the defendant would be out of pocket to the extent of its general overheads, even though no product could have been produced or sold without the overheads being incurred. If the infringing product was the first of a range of products, Dart's contention would require that it alone should bear the cost of the overheads. That would be to the detriment of the plaintiff.

The foregoing considerations require the rejection of Dart's contention. But upon what principle or rule is an allowance to be made for general overheads?

What is the principle for allocating overheads?

In a litigious world of unlimited time and resources, the best approach for determining the profit derived from the infringement might be to estimate the profit of the product after allowing a proportion of the overheads and then deduct the opportunity cost of producing the infringing product. This would show the true gain of the infringer from producing or distributing the infringing product instead of the next best alternative. Another but less exact method of determining the profit and preventing the unjust enrichment of the infringer might be to determine what was the best alternative open to the infringer, determine what gross revenue would have been obtained from that alternative, and deduct that sum from the gross revenue obtained from the infringing product. Another suggested method is that there should be a deduction for that part of the overhead which would have been absorbed in producing or selling the alternative to the extent that it was used in producing or selling the infringing product. But to adopt any of these methods would make an often complex subject more complex than it already is. Very likely, it would increase the prospect of contested litigation over the taking of the account and the cost and length of the hearing while the parties and their witnesses investigated and debated the hypothetical. Depending on which method was used, the person taking the accounts would have to *estimate* one or more of the following figures: the gross revenue from the alternative, the direct costs of the alternative and the proportion of overhead attributable to the alternative. Lindley L.J., who knew more about accounts of profits than most lawyers, once said[54] that he did "not know any form of account which [was] more difficult to work out, or may be more difficult to work out than an account of profits". The Court should be slow to adopt a rule which might increase that difficulty.

A more practical approach is to apply those commercial and accounting principles which are used in business to determine what profit has resulted from the manufacture or sale of a product. In *Q.B.E. Insurance Group Ltd. v Australian Securities Commission*,[55] Lockhart J. pointed out:

> The meaning of the word "profits" is for the courts to determine. But the identification of what in relation to the affairs of a particular company constitutes its profits is determined by the courts with close regard to the views of the accountancy profession. The courts are influenced strongly by the views adopted by professional accountancy bodies and men of business and the evidence of accountants is given great weight by the courts.

Admittedly, the commercial or accounting approach may mean that, in the account of profits, the infringer is credited with an amount of overhead greater than would be the case if no infringement had taken place. But the converse may sometimes be true. Whatever the outcome in a particular case may be, the commercial or accounting approach has one clear advantage over other methods: it deals with historical facts and commercial reality and not hypotheses.

To determine the cost of a particular product, cost accountants use the incremental method of accounting and the absorption method of accounting. "Incremental (or marginal) cost" has been defined as "the change in aggregate cost that accompanies the addition or subtraction of a unit of output".[56] The incremental method is generally used for setting short term prices and for one-time tactical decisions.[57] It focuses on the marginal difference in costs (or revenues) as a result of adding a unit of production. In contrast, the "absorption (or average or full costing)" method allocates all fixed costs between the products of the business.[58]

[54] *Siddell v Vickers* (1892), 9 R.P.C. 152, at p. 162.
[55] (1992) 38 F.C.R. 270, at pp. 288-289; see also *Odeon Associated Theatres Ltd. v Jones* [1973] Ch288, at p. 299.
[56] *Kohler* , op. cit., p. 257.
[57] Hirsch, Advanced Management Accounting (1988), pp. 50-51.
[58] Helmkamp, Managerial Accounting (1987), pp. 165, 239, 550; Hirsch, op. cit., p. 51.

Standard accounting text books recognize that, in calculating the cost of a product for the purpose of identifying its profitability, all costs which contribute to the ultimate sale of the product must be included (i.e, the absorption method should be used).[59] A decision to initiate, continue or discontinue the production or sale of a product will not be made solely on the data generated by incremental cost accounting. It is the product's effect on the viability of the business as a whole which is important. If an additional product has only a small contribution margin but helps to defray the general overheads of a firm (e.g., by lowering the total cost per unit of running a machine), then it is more likely to be added to the range than if it did not absorb such costs. This concept of further spreading or absorbing general overheads was recognized in *Sammons v Colonial Press*[60] where the Court of Appeals for the First Circuit stated:

> Manufacturers are frequently glad to make a contract at a price which yields no net profit on a strict cost accounting basis but which does yield sufficient profit to carry a portion of the inescapable overhead.

In the present case, the question under the incremental method of accounting would be: "By what amount have the general overhead costs increased as a result of the addition of the press button canisters to the respondents' range of products?" Under this method, only that increase would be deductible from the gross profit of the infringing product. The question under the absorption method would be: "To what extent did the incurring of the overheads assist in the derivation of revenue from the infringing product?"[61] Only the absorption method will reveal whether Decor or Rian made a profit from the infringement.

Other branches of the law have rejected the incremental method of accounting as a basis for determining the cost of a product. In *Philip Morris Ltd. v Federal Commissioner of Taxation*,[62] Jenkinson J. held that the adoption of the direct costing or incremental method of costing would not reflect the "cost price" of trading stock for the purpose of s. 31(1) of the *Income Tax Assessment Act 1936 Cth*. His Honour held that the absorption costing method was the

[59] Helmkamp, op cit., p. 239; Hirsch, op. cit., p. 51.
[60] (1942) 126 F. 2d, at p. 348.
[61] See Alfred Bell (1949), 86 F. Supp., at p. 415.
[62] (1979) 38 F.L.R. 383; 10 A.T.R. 44; 79 A.T.C. 4,352.

appropriate method. In *E. I. Du Pont de Nemours & Co. v Commissioner of Patents [No. 3]*,[63] Hodgson J. held that, in determining the profits of a patentee for the purpose of s. 93(b) of the *Patents Act 1952 Cth*, it was appropriate to apportion the general overheads of the plaintiff's business. His Honour expressly rejected[64] the submission "that there should be charged against the income from [the] patent only amounts by which it could be shown that the PET project increased the general overheads of the plaintiff's business". The learned judge said that, if that proposition was applied to every project undertaken by the plaintiff, none of the general overheads of the business might be charged against any project at all. Similarly in *Re Application of Pfizer Inc.*,[65] Hodgson J. held that, in determining whether a patentee had been inadequately remunerated within the meaning of s. 94 of the *Patents Act 1952*, it was appropriate to charge against gross receipts derived in Australia "a proportion of the overall expenditure on the product and of the appropriate amount of non-productive research, on the basis of Australia's approximate share or percentage of the overall world market".

The United States authorities

Cases in the United States support the use of the absorption method of accounting in determining the cost of an infringing product in an account of profits. Differences between the intellectual property legislation of this country and the United States mean that the United States cases must be used cautiously in Australia. Nonetheless, as Windeyer J. pointed out in *Colbeam Palmer Ltd. v Stock Affiliates Pty. Ltd.*,[66] "if used with discrimination, American decisions on the point are illuminating and helpful".

The main idea which runs through the American cases is that the absorption method of accounting should be adopted in relation to general overheads which can reasonably be shown to have assisted in the derivation of revenue from an infringing product. Mr. Ellicott Q.C., for Decor, referred the Court to numerous cases (dating from 1874 to 1985) illustrating this proposition. However, the current position in the United States is succinctly and conveniently

[63] (1989) 15 I.P.R. 296.
[64] (1989) 15 I.P.R., at p. 307.
[65] (1986) 4 N.S.W.L.R. 566, at p. 571.
[66] (1968) 122 C.L.R., at p. 44.

summarized in Nimmer on Copyright.[67] The learned author declares that the question of which expenses will be regarded as deductible costs:

> will generally turn upon the definition of costs under accepted accounting practices. In general it may be said that only those expenses which are proven with some specificity to relate to the infringing work may be deducted in determining the profits attributable to such work.
>
> A proper allocation of that portion of defendant's overhead attributable to the cost of the said infringing items may be deducted, at least where the infringement was not conscious and deliberate. This determination of overhead presents an issue of fact. The defendant has the burden of proving that each item of general expense contributed to the production of the infringing items, and of further offering a fair and acceptable formula for allocating a given portion of overhead to the particular infringing items in issue. The appropriate formula for allocation may well vary in different industries. For example, it has been held that a music publisher's overhead should be allocated on the basis of the number of songs published in a given period, without reference to the number of copies sold of each such song. This is to be compared with the overhead of a motion picture producer where it has been held that overheads should be allocated according to the direct cost of production of each motion picture.

It is useful to refer to some United States cases to illustrate the application of those principles.

In The Tremolo Patent,[68] the Supreme Court held that, in an account of profits arising out of the infringement of a patent, the defendant was entitled to prove the general expenses incurred in the business affecting the sale of all its goods and deduct a rateable proportion from the profits made by the sale of the infringing product. Strong J., delivering the opinion of the Court, said:[69]

> We cannot see why the general expenses incurred by the defendants in carrying on their business, such expenses as store rent, clerk hire, fuel, gas, porterage, etc., do not concern one part of their business as much as another. It may be said that the selling [of] a Tremolo attachment did not add to their expenses, and, therefore, that no part of those expenses should be deducted from the price obtained for such an attachment. This is, however, but a partial view.

In *Schnadig*,[70] the United States Court of Appeals, Sixth Circuit, said:

> By definition, the stipulated fixed expenses would have been incurred regardless of

[67] Vol. 3, §14.03[B]; see also McCarthy, Trademarks and Unfair Competition, 2nd ed. (1984), vol. 2, §30:26B.
[68] (1874) 90 U.S. 518.
[69] ibid., at pp. 528-529.
[70] (1980) 620 F. 2d, at p. 1172.

> whether the incremental infringing production of Suite 495 had been undertaken. Because these expenses were neither caused nor increased by the infringing production, it may be argued that the infringer should not be permitted to avoid the expense by passing it on [to] the patentee. The response to this argument is that these expenses are necessary for each component of production. Suite 495 could not have been produced without expenses for utilities, administrative salaries, building space and the like being incurred. Viewed in this light, the fixed expenses are as necessary to the infringing production as are the variable expenses, and should be similarly treated.

In *Sheldon v Metro-Goldwyn Pictures Corp.*,[71] which concerned the copyright infringement of a play, the United States Court of Appeals for the Second Circuit allowed a deduction for general overhead. Judge Learned Hand, speaking for the Court, said:
In the case at bar the infringing picture was one of over forty made by the defendants, using the same supervising staff and organization, which had to be maintained if the business was to go on at all. Without them no picture could have been produced; they were as much a condition upon the production of the infringing picture as the scenery, or the plaintiff's play itself.

Upon the same principle, the Court also allowed a proportionate deduction for the cost of pictures never exhibited, such wastage "being a condition upon all production" and therefore "a part of the cost of production".[72] The decision was affirmed by the Supreme Court of the United States.[73]

Dart referred the Court to a number of United States authorities where the incremental (differential) cost accounting approach has been adopted. However, the great majority of these decisions concerned wilful infringements of intellectual property rights. Where infringement is wilful, courts in the United States are less inclined (for punitive reasons) to allow deductions for overhead than where infringement is innocent.

Thus, in *Regis v Jaynes*[74] which concerned an appeal against an accounting of profits stemming from the deliberate and wrongful use of a trade mark, the Master, whose decision was upheld

[71] (1939) 106 F. 2d 45, at p. 54.
[72] (1939) 106 F. 2d 45, at p. 54.
[73] See *Sheldon v Metro-Goldwyn Pictures Corp.* (1940), 309 U.S. 390.
[74] (1904) 70 N.E. 480 (Mass.).

by the Supreme Judicial Court of Massachusetts,[75] refused to allow any deductions for general overheads. Similarly, in *Carter Products Inc. v Colgate-Palmolive Co.*,[76] which concerned an extreme form of deliberate infringement of trade marks and trade secrets, the rejection of a deduction for general overheads was upheld. The Court said that the cases "indicate that the *Tremolo* rule should be applied unless special circumstances would make its application unjust"[77]. The Court then pointed to several circumstances, such as Colgate's deliberate and persistent wrongful acts, which made the application of the *Tremolo* rule unjust in that case.

Most decisions in the United States which have applied the incremental approach to an account of profits are, therefore, distinguishable on the basis of deliberate infringement. They are not of direct relevance to the Australian position. If there are United States cases which have applied the incremental approach to a situation of innocent infringement, as I think there are,[78] they are contrary to the mainstream approach adopted in the United States. They are also inconsistent with the commercial and economic principles and rationales for determining the profit derived from a product. This Court should not follow them.

The conflict in the United States cases can also be explained on another basis. In *Schnadig*,[79] the Court of Appeals, Sixth Circuit, said:

> The common thread running through the cases which have addressed this issue is a grant of considerable discretion to the trial court. Although the proper treatment of fixed expenses can be viewed as a question of law, most courts have perceived the real question to be the relationship between the particular fixed costs and the infringing production in each case, and this has been treated as a question of fact.

The Australian cases

In support of his argument that incremental cost accounting is the appropriate method to be used in ascertaining an account of profits from an infringing product, counsel for Dart relied strongly on *Leplastrier & Co. Ltd. v Armstrong-Holland Ltd.*[80] In determining the principles

[75] (1906) 77 N.E. 774.
[76] (1963) 214 F. Supp. 383.
[77] (1963) 214 F. Supp., at p. 402.
[78] See, e.g., *Century Distilling Co. v Continental Distilling Corp.* (1953), 205 F. 2d (3d Cir.) 140.
[79] (1980) 620 F. 2d, at p. 1174.
[80] (1926) 26 S.R. (N.S.W.) 585.

applicable for an account of profits, Harvey C.J. in Eq. adopted the "sole referability" test (which essentially corresponds to the incremental method of cost accounting). However, Leplastrier's Case should not be regarded as authoritative at the present day. First, I suspect that the theory and practice of cost accounting in Australia were not as sophisticated in 1926 as they are today. Secondly, however that may be, the decision was made without reference to authority and without regard to the decisions in the United States. Indeed, Harvey C.J. in Eq. said:[81]

> As far as I can find, there are no authorities in the English books — and counsel could not find them — and I am exceedingly obliged to counsel for their forbearance in not venturing on the maze of American authorities, where the cases are legion. I have not embarked on an investigation of them either.

For these reasons, Leplastrier's Case is not a persuasive authority. The concept of "solely referable" as the benchmark for the deductibility of overhead expenses in relation to an account of profits of an infringing product is contrary to business theory and practice. It is also contrary to the overwhelming weight of authority in the United States whose courts have had long experience in this field.

Dart also relied on the decision of Windeyer J. in Colbeam Palmer[82] which concerned the infringement of a trade mark in relation to the painting sets. Part of his Honour's direction to the Registrar was that in taking the account of profits, there was to be included the total cost to the defendant of[83]:

> selling and delivering the articles so sold to the buyers of them. This will include any costs directly attributable to such sales and deliveries. But it should not, I think, include any part of the general overhead costs, managerial expenses and so forth of the defendant's business, as it seems that all these would have been incurred in any event in the ordinary course of its business in which as it was put in evidence the painting sets were a "side line".[84]

Counsel for Dart submits that this passage means that "one excludes "general overhead costs, managerial expenses and so forth of the defendant's business", because all these would have

[81] (1926) 26 S.R. (N.S.W.), at p. 593.
[82] (1968) 122 C.L.R. 25.
[83] ibid., at p. 39.
[84] cf. *Leplastrier* (1926), 26 S.R. (N.S.W.) 585.

been incurred, in any event, in the ordinary course of its business". However, it is clear that Windeyer J. was expressly confining his statement to cases of "side line" products. Those cases involve short term decisions to make and/or sell a product on the basis of utilizing excess capacity or for short term promotions or gains. Whether the side line exception is good law is debatable. However, it is unnecessary to express any concluded view on the subject because the trial judge found that the infringement in the present case was not a side line activity.

The Teledyne Case

Dart also relied on the leading Canadian case on accounting for profits.[85] In *Teledyne* , the Federal Court (Trial Division, Addy J.) applied the incremental method which was referred to in that case as the "differential or direct cost accounting method". Addy J. said[86] that to allow the infringer to deduct "such part of all of its fixed costs as might be attributable proportionately to the operation" would constitute in effect unjust enrichment. For the reasons that I have given, however, this analysis, with respect, is flawed.

The absorption method is the proper approach for allocating overheads

Based on the above analysis of accounting and economic principles and practice, as well as the United States cases, the absorption method of cost accounting is the appropriate method of accounting for general overheads in a case of infringement. The test to be applied was concisely stated in *Alfred Bell & Co. v Catalda Fine Arts*[87] where the Court said:

The test is not whether such an overhead item had been increased by the handling of the infringements but whether this overhead item actually assisted in the production of the infringing profits.

Whether the overhead did actually assist in the production or sale, etc. of the infringing product will be a question of fact in all the circumstances of the case. In determining that question, the judge will need to keep two matters in mind. First, the smallness of the sales volume of the infringing product in the defendant's range is not a ground for refusing to allocate any

[85] *Teledyne Industries Inc. v Lido Industrial Products* (1982), 68 C.P.R. (2d) 204, esp. at pp. 210-214; followed in *Hutton v Canadian Broadcasting Corp.* (1989), 29 C.P.R. (3d) 398, at pp. 458-459.
[86] *Teledyne* (1982), 68 C.P.R. (2d), at p. 210.
[87] (1949) 86 F. Supp., at p. 415.

proportion of overheads to the infringing product. Thus, in *Kamar International Inc. v Russ Berrie & Co. Inc.*,[88] the Court of Appeals for the Ninth Circuit refused to disallow a deduction for overheads merely because the sales of the infringing items constituted a small percentage of total sales. Secondly, the plaintiff must take the business of the infringer as it is, as Judge Learned Hand pointed out in *Sheldon*.[89] The plaintiff is confined to the profits actually made. It is irrelevant that the defendants could have used their resources in a more efficient way and generated a higher profit.

Onus of proof

The defendant/infringer bears the onus of showing which overheads assisted in the production or sale of the infringing product and of providing a fair basis for allocating the overheads. In *Frank Music Corp. v Metro-Goldwyn-Mayer Inc.*,[90] the Court of Appeals for the Ninth Circuit pointed out that an infringer does not need to prove its overhead expenses and their relationship to the infringing production in minute detail, but nevertheless:

> [A] deduction for overhead should be allowed "only when the infringer can demonstrate that [the overhead expense] was of actual assistance in the production, distribution or sale of the infringing product" We do not take this to mean that an infringer must prove his overhead expenses and their relationship to the infringing production in minute detail [T]he defendant bears the burden of explaining, at least in general terms, how claimed overhead actually contributed to the production of the infringing work.[91] ("It is too much to ask a plaintiff who has proved infringement also to do the defendant's cost accounting.").

In the earlier decision of *Sammons*,[92] the Court of Appeals, First Circuit, said:

> The burden thus cast upon the defendant requires him to give evidence of more than a blanket undifferentiated item of "overhead"; he must give satisfactory evidence of each item of general expense or overhead, show that each item assisted in the production of the infringement, and offer a reasonably acceptable formula for allocating a portion of the general overhead to the particular job. A theoretically perfect allocation is impossible, but there must be a rough approximation within the limits of practicality.

[88] (1984) 752 F. 2d 1326, at p. 1333.
[89] (1939) 106 F. 2d 45; approved by the United States Supreme Court in *Sheldon v Metro-Goldwyn Pictures Corp.* (1940), 309 U.S. 390.
[90] (1985) 772 F. 2d 505, at p. 516.
[91] See *Kamar* (1984), 752 F. 2d, at p. 1333; *Taylor v Meirick* (1983), 712 F. 2d 1112 (7th Cir.), at pp. 1121-1122.
[92] (1942) 126 F. 2d, at p. 349. For an illustration where the defendant did not satisfy this burden of proof, see *Manhattan Industries v Sweater Bee By Banf. Ltd.* (1989), 885 F. 2d 1 (2d Cir.), at pp. 7-8.

Method of allocation

By definition it is not possible to allocate general overhead specifically or with absolute precision to each product in a range of products. In proof of the assistance which the general overhead made to the derivation of revenue from the infringing product, "what is required is not mathematical exactness but only a reasonable approximation".[93] Further, the appropriate method of allocation will depend upon the nature of the business in question and the circumstances of the cases. In Frank Music,[94] the Court stated: "Because a theoretically perfect allocation is impossible, we require only a "reasonably acceptable formula"." The accounting method generally used by the producer in the ordinary course of its business will usually be regarded by the courts as a "reasonably acceptable formula". In *Rubber Co. v Goodyear*,[95] the Court stated: "The calculation is to be made as a manufacturer calculates the profits of business."

The sales ratio form of allocation (proposed by the respondents in the present case) has been endorsed as an acceptable formula in a number of United States cases[96] and by writers.[97] There is no reason for not accepting it in the present case.

A "side line" exception to the general principle?

One potential qualification to the general principles stated above may be "side line" activities. The judgment of Windeyer J. in Colbeam Palmer would support such an exception. However, the argument that overhead is a necessary element of the production of any good and the concept of opportunity cost are as applicable to "side line" activities as to other activities. If the infringer can prove that its overhead assisted the production or sale of the sideline product and

[93] *Sheldon* (1940), 309 U.S., at p. 408; see also Frank Music (1985), 772 F. 2d, at p. 516; *Manhattan Industries* (1989), 885 F. 2d, at pp. 7-8.
[94] (1985) 772 F. 2d, at p. 516; see also *Myers v Callaghan* (1885), 24 F. 636 (C.C.N.D. Ill.), at pp. 638, 639; same case on appeal, sub nom. *Callaghan v Myers* (1888), 128 U.S. 617; *Sheldon* (1939), 106 F. 2d, at pp. 52, 53; affirmed (1940) 309 U.S. 409; *Levin Bros. v Davis Manufacturing Co.* (1934), 72 F. 2d 163 (8th Cir.); *Ruth v Stearns-Roger Manufacturing Co.* (1935), 13 F. Supp. 697 (D.C.D. Colo.); *Sheldon v Moredall Realty Corporation* (1939), 29 F. Supp. 729 (D.C.S.D.N.Y.), at p. 731.
[95] (1870) 76 U.S. 788, at p. 804; cited with approval in *Sammons* (1942), 126 F. 2d, at pp. 348-349.
[96] See Frank Music (1985), 772 F. 2d, at p. 516; *Kamar* (1984), 752 F. 2d 1326; *Aitken, Hazen, Hoffman, Miller v Empire Construction Co.* (1982), 542 F. Supp. 252; *Wolfe v National Lead Co.* (1959), 272 F. 2d 867 (9th Cir.); *Sammons* (1942), 126 F. 2d 341.
[97] See, e.g., McCarthy, op. cit., §30:26B.

can provide a fair and reasonable method of allocation, it is difficult to see why a proportion of overhead should not be allowed.

Order

In my opinion the appeal should be dismissed, but I would substitute the words "assisted in" for the words "contributed to" in the Full Court's order.

For the reasons given by Mason C.J., Deane, Dawson and Toohey JJ., the application for special leave to cross-appeal should be dismissed.