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Trade Regulation—Section 35 of Lanham Act—Accounting for Profits. *Monsanto Chem. Co. v. Perfect Fit Prod. Mfg, Co*

David L. Clancy

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tion in *Ekco* differed from that in *Reynolds* and *Procter* in that, McClintock being a monopoly, *Ekco* entered a line of commerce in which there was no competition to lessen. In view of this fact, the court felt it could not predict anticompetitive effects on the basis of the acquisition alone and therefore required post-acquisition evidence. The court pointed out that its holding applied only to the narrow factual situation of the *Ekco* case. In all probability, however, *Ekco* should be read as consistent with *Smith-Victor* in requiring post-acquisition evidence or some additional fact to invalidate a corporate acquisition on the basis of the deep-pocket theory. The courts' requirement seems to reflect a belief that the deep-pocket theory is a per se theory of illegality³⁰ and therefore unacceptable. In fact, however, the deep-pocket theory simply raises a strong presumption of illegality—a presumption which the defendant can rebut by coming forth with conclusive proof that the deep pocket will not be used or that the theory does not apply to his case.

MICHAEL J. BALANOFF

Trade Regulation—Section 35 of Lanham Act—Accounting for Profits.—*Monsanto Chem. Co. v. Perfect Fit Prod. Mfg. Co.*¹—Plaintiff Monsanto manufactures and markets an acrylic fiber under its registered trademark "Acrilan."² Monsanto sold twenty thousand pounds of this fiber to defendant Perfect Fit which used it in the manufacture of mattress pads. Defendant sold them with labels bearing plaintiff's trademark and representing to customers that the mattress pads were one hundred per cent Acrilan. Monsanto purchased and analyzed several of these and determined that none contained more than twenty-five per cent Acrilan and some contained no Acrilan at all. Perfect Fit admitted the mislabeling and met with Monsanto in July and August of 1958, but no settlement was reached. In November of 1958, Monsanto initiated a federal suit in the Southern District of New York for trademark infringement and unfair competition.

The district court, sitting without a jury, found that Perfect Fit had infringed Monsanto's trademark and that Perfect Fit had "deliberately attempted to capitalize on the reputation which plaintiff had established for its acrylic fiber."³ The court issued a permanent injunction and awarded legal

³⁰ *Ekco* argued that the Commission had applied an absolute prohibition against all acquisitions of small firms by large firms without regard to other factors. *Supra* note 2, at 751. The deep-pocket theory, however, is not a per se theory of illegality, although it approaches one. It is not every acquisition of a small firm by a large firm that is likely to have the substantial lessening of competition effects proscribed by § 7. In some cases the acquisition may tend to increase competition. Some acquisitions may be de minimis and have such a slight impact on competition, if any, that the law will take no notice of them. The fact situation of each case will still be examined; the deep-pocket theory, however, will make it more difficult to prove that the merger should not be invalidated.

¹ 349 F.2d 389 (2d Cir. 1965), petition for cert. filed, 34 U.S.L. Week 3192 (U.S. Nov. 24, 1965) (No. 763).

² 646 O.G. Pat. Off. 387 (1951); 674 O.G. Pat. Off. 575 (1953).

³ *Monsanto Chem. Co. v. Perfect Fit Prod. Mfg. Co.*, 232 F. Supp. 493, 494-95 (S.D.N.Y. 1964).

fees, but held that Monsanto had failed to prove any damages. The court refused to allow Monsanto an accounting for Perfect Fit's profits, as provided for in Section 35 of the Lanham Act,⁴ on the ground that the parties were not in direct competition, citing as authority the Second Circuit's decisions in *Admiral Corp. v. Penco, Inc.*⁵ and *Triangle Publications, Inc. v. Rohrlich*.⁶ Both parties appealed.

The Second Circuit Court of Appeals reversed the district court on the issue of accounting, but otherwise affirmed the decision. HELD: Direct competition is not required for an accounting of the infringer's profits and *Admiral Corp. v. Penco, Inc.*⁷ and *Triangle Publications, Inc. v. Rohrlich*⁸ are overruled insofar as they are inconsistent with the present holding. The appellate court concluded that, given a willful infringement, the purposes and language of the Lanham Act are best served by granting an accounting on the theory of restitution of profits unjustly obtained at the trademark owner's expense, and the requirement of direct competition does not adequately protect either the trademark owner's or the public's interest in being free from this type of fraud.

The now equitable remedy of accounting, which devolved from the early common law action of account-render,⁹ is properly based on restitution of benefits unjustly obtained.¹⁰ At common law, the action was seldom used successfully due to the effort required to surmount the technicalities of pleadings, and also because it was held to be available only on a certain fact situation.¹¹ Although the remedy at law was thus inadequate, it was soon adopted by the chancery court. The wrongdoer is in a position similar to that of a trustee ex maleficio and is compelled to transfer the benefits to the person entitled to them.¹²

The criteria by which an accounting is awarded in federal trademark infringement cases are determined by the court's view of the nature of the protectable interest the trademark owner has in his mark. Most federal courts have held that a trademark is property in that the holder of the mark is entitled to exclusive possession and use as long as he continues to resort to it for the identification of his product.¹³ Thus, when an infringer deliberately appropriates the mark or symbol for his own benefit, these "property" courts will grant relief to the trademark owner, usually in the form of a permanent injunction. In addition, many courts have awarded plaintiff an accounting of

⁴ 60 Stat. 427 (1946), 15 U.S.C. § 1117 (1964).

⁵ 203 F.2d 517 (2d Cir. 1953).

⁶ 167 F.2d 969 (2d Cir. 1948).

⁷ *Supra* note 5.

⁸ *Supra* note 6.

⁹ 2 Nims, *Unfair Competition and Trademarks* § 424 (4th ed. 1947); 4 Pomeroy, *Equity Jurisprudence* § 1420 (5th ed. 1941).

¹⁰ *Blue Bell Co. v. Frontier Ref. Co.*, 213 F.2d 354, 363 (10th Cir. 1954); *Restatement, Restitution* §§ 1, 136 (1937).

¹¹ Pomeroy, *supra* note 9, at 1076 n.9.

¹² *Hamilton-Brown Shoe Co. v. Wolf Bros.*, 240 U.S. 251, 259 (1916); *Blue Bell Co. v. Frontier Ref. Co.*, *supra* note 10.

¹³ *Hamilton-Brown Shoe Co. v. Wolf Bros.*, *supra* note 12; *Trade Mark Cases*, 100 U.S. 82, 92-93 (1879).

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the defendant's profits although the theory supporting such an award has never been clearly enunciated.¹⁴ To this extent, these courts were using accounting in a restitution sense although no court expressly adopted the restitution theory.

On the other hand, many courts, cited below, have held that a money award should not be granted in a trademark infringement case unless the plaintiff can show that his business has been injured by the defendant's conduct. As applied to accounting, this theory is incorrect and ignores the distinction between restitution, based on the right of the trademark holder to be the only one entitled to the use of his mark, and damages, based on the right of the trademark holder to be indemnified against loss caused by a tortious infringement. Where this injury theory is used by the court, accounting becomes merely another type of damages.

These "injury" courts can be divided into two groups. A small minority of decisions hold that a trademark is not property and the trademark owner has no exclusive right to the benefits of the use of his mark.¹⁵ This is derived from the idea that there is nothing tangible in a trademark which can become the subject of property and thus be "owned" by any one person. Therefore, the trademark owner will be compensated only for his injuries. Other injury courts, although not expressly rejecting the property theory of trademarks, have nevertheless refused to award an accounting in cases where the plaintiff does not show injury, on the ground that it is inequitable to allow him a money recovery unless he has been injured by the infringement.¹⁶ Both of these types of decisions lead to the same result: the trademark owner is not entitled to an accounting unless he can prove injury.

There are many valid reasons for refusing to grant an accounting in a particular case,¹⁷ but to base the denial solely on the inability of the trademark owner to prove injury is a confusion of restitution and damages. Further, the equability of permitting a commercial parasite to retain his unjustly earned profits is doubtful. The practical aspects of such a requirement are examined below.

The kinds of injury recognized in infringement suits include injury to reputation or to good will and loss of profits from direct sales. In order to recover damages for these injuries, the trademark owner must show (1) that he has suffered a loss, (2) the extent to which he has been injured, and (3) that the injury was caused by the defendant's infringement.

It has been all but impossible for the trademark owner to successfully carry the above burdens of proof in relation to injury to reputation or to

¹⁴ E.g., *Hamilton-Brown Shoe Co. v. Wolf Bros.*, 240 U.S. 251 (1916); *Maternally Yours, Inc. v. Your Maternity Shop, Inc.*, 234 F.2d 538 (2d Cir. 1956); *Century Distilling Co. v. Continental Distilling Corp.*, 205 F.2d 140 (3d Cir. 1953).

¹⁵ *Prestonettes, Inc. v. Coty*, 264 U.S. 359, 368 (1924); *Durable Toy & Novelty Corp. v. J. Chein & Co.*, 133 F.2d 853, 854 (2d Cir. 1943).

¹⁶ *McCormack & Co. v. Manischewitz Co.*, 206 F.2d 744, 747 (6th Cir. 1953); *Veatch v. Wagner*, 116 F. Supp. 904, 906 (D.C. Alaska 1953); *Stardust, Inc. v. Weiss*, 79 F. Supp. 274, 281 (S.D.N.Y. 1948).

¹⁷ Nims, *supra* note 9, § 428A provides a list of reasons why an accounting should not be granted. For example: Where the defendant has acted in good faith; where both parties are at fault; where there has been laches or acquiescence.

good will because of the intangibility of such assets.¹⁸ Indeed, it is usually impossible for the plaintiff to prove a direct sales loss or a loss analogous to direct sales loss unless the parties are competing. Since, in an injury court, proof of injury is a prerequisite for accounting as well as for damages, it is very unlikely that the plaintiff will receive any money recovery at all. Moreover, there are no criminal sanctions in federal trademark law. Thus, the public policy which demands that this type of fraudulent conduct be discouraged cannot be effected in an injury court.

It is submitted that in an attempt to avoid these undesirable results, the injury courts "relaxed" the plaintiff's burden of proof to the extent that, in a situation where the parties were competing, the courts inferred that the deliberate infringement must have caused plaintiff a loss of profits due to diversion of sales.¹⁹ Since the injury courts thus eliminated the difficult tasks of proving loss and causation insofar as this type of damages (direct sales loss) was concerned, the largely unsuccessful attempts to prove other types of damages were abandoned, and the whole problem of proof of damages devolved into the lesser problem of proving competition. Few could prove damages without the aid of the relaxation; thus the relaxation became the "rule" of direct competition.²⁰ In an injury court, accounting depended upon proof of injury, so the direct competition rule was applied to accounting.

This rule is not only inadequate as a panacea for attempted proof of damages,²¹ but under the proper restitution approach would be entirely irrelevant to the issue of accounting. Moreover, under the direct competition rule, plaintiff must still prove the extent of his loss to receive an accounting in an injury court.²² This problem would not arise in a restitution setting since extent of injury would have no bearing on the issue of accounting.

Since injury courts require direct competition and property courts do not,²³ it is clear that there is no uniform treatment of accounting in federal

¹⁸ Some states have alleviated the problem in this area by the passage of anti-dilution statutes. E.g., Mass. Gen. Laws Ann. ch. 110, § 7A (1958):

Likelihood of injury to business reputation or of dilution of the distinctive quality of a trade name or trade-mark shall be a ground for injunctive relief in cases of trade-mark infringement or unfair competition, notwithstanding the absence of competition between the parties. . . .

Although this statute does not provide for a money recovery, it does predicate the allowance of an injunction merely on the showing of "likelihood of injury" and does not require proof of injury. Similar statutes may be found in Ga. Code Ann. § 106-15 (1956); Ill. Ann. Stat. ch. 140, § 22 (1964); and N.Y. Gen. Bus. Law § 368D (Supp. 1965).

¹⁹ See *Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co.*, 316 U.S. 203, 206 (1942).

²⁰ *Admiral Corp. v. Penco, Inc.*, supra note 5, at 521; *National Dryer Mfg. Corp. v. National Drying Mach. Co.*, 136 F. Supp. 886, 887 (E.D. Pa. 1955).

²¹ For a discussion of direct sales damages that do not depend on competition, see note 39 infra and accompanying text.

²² See, e.g., *Vogue Co. v. Thompson-Hudson Co.*, 300 Fed. 509, 512 (6th Cir. 1924); *Acme Chem. Co. v. Dobkin*, 68 F. Supp. 601, 615 (W.D. Pa. 1946).

²³ *Baker v. Simmons Co.*, 325 F.2d 580, 582 (1st Cir. 1963); *Blue Bell Co. v. Frontier Ref. Co.*, supra note 10.

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trademark case law. In fact, both the property and the injury theories have been employed in the same circuit.²⁴ The result is confusion.

This confusion has been augmented by careless usage of the word "profits." In the proper context of accounting, "profits" refers only to the profits realized by the infringer and not to the profits which the trademark owner may have lost through diverted sales. The trademark owner's "lost profits" is only one form that his damages may take and has nothing to do with accounting.

This distinction was recognized by the Trademark Act of 1905²⁵ and the Lanham Act of 1946,²⁶ both of which allow the plaintiff to recover defendant's profits, his own damages, and the costs of the action. Section 35 of the Lanham Act provides:

When a violation of any right of the registrant of a mark registered in the Patent Office shall have been established in any civil action arising under this Act, the plaintiff shall be entitled, . . . subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action In assessing profits the plaintiff shall be required to prove defendant's sales only; defendant must prove all elements of cost or deduction claimed.²⁷

Thus, under this act, neither direct competition nor proof of injury is relevant to the issue of accounting. In fact, in a proper case, there is no reason why the trademark owner cannot recover both the defendant's profits (through an accounting) and his own damages.²⁸

Despite the above language in section 35, injury courts have continued to require proof of injury and direct competition for accountings. The policy that it is inequitable to award an accounting absent proof of injury is so ingrained in these courts that they have interpreted the phrase "subject to the principles of equity" in section 35 to be a reaffirmation of this policy. Thus, in an injury court, plaintiff has no broader base of relief under the Lanham Act than he had previous to its enactment.²⁹

Judge Giles Rich of the United States Court of Customs and Patent Appeals commented generally on the federal judiciary and the Lanham Act:

In such a changing field texts get out of date, cases get out of date. The statute got out of date and 8 years were spent producing the Lanham Act, which is filled with strange and wonderful things!

²⁴ In the Third Circuit, compare *Admiral Corp. v. Price Vacuum Stores, Inc.*, 141 F. Supp. 796 (E.D. Pa. 1956), with *National Dryer Mfg. Corp. v. National Drying Mach. Co.*, 136 F. Supp. 886 (E.D. Pa. 1955). For Second Circuit cases, see text accompanying notes 31-35 *infra*.

²⁵ 33 Stat. 724, 729.

²⁶ 60 Stat. 427 (1946), 15 U.S.C. § 1117 (1964).

²⁷ *Ibid*.

²⁸ *Pastificio Spiga Societa v. De Martini Macaroni Co.*, 200 F.2d 325, 327 (2d Cir. 1952); *Aladdin Mfg. Co. v. Mantle Lamp Co.*, 116 F.2d 708, 715-16 (7th Cir. 1941).

²⁹ *Admiral Corp. v. Penco, Inc.*, *supra* note 5, at 521; *Triangle Publications, Inc. v. Rohrlich*, *supra* note 6, at 974.

Very few members of the Federal judiciary have had much initiation into its mysteries.⁸⁰

The situation in the Second Circuit is illustrative of the confusion prevalent in the federal circuits. In *Durable Toy & Novelty Corp. v. J. Chein & Co.*,⁸¹ the appellate court specifically rejected the idea that a trademark is property. And in *Triangle Publications, Inc. v. Rohrlisch*⁸² and *Admiral Corp. v. Penco, Inc.*,⁸³ the same court refused to award an accounting because the parties were not competing. On the other hand, there are indications of proper use of accounting. In *Maternally Yours v. Your Maternity Shop*,⁸⁴ the court held that the infringer must account for his profits, even in areas where he did not compete with the trademark owner. Finally, in *Dad's Root Beer Co. v. Doc's Beverages, Inc.*,⁸⁵ the court not only ordered an accounting although there was no competition, but also used strong restitution language in referring to the infringer as a trustee of the profits for the trademark owner.⁸⁶ The *Monsanto* decision, expressly adopting the restitution theory for the first time and discarding the direct competition rule as applied to accounting, has settled the problem, at least for the Second Circuit.

Unfortunately, the impact of the *Monsanto* decision is impaired by confusing language in the opinion. Although the majority affirmed the lower court's finding of no damages, the treatment of the accounting issue is obscured by frequent reference to Monsanto's "damages."⁸⁷ In addition, the court states that "compensation for diverted trade is one important purpose which an accounting may serve."⁸⁸ This is entirely inconsistent with the restitution theory of accounting. Accounting has been used as compensation for diverted trade, but this is a misuse. Recovery for diverted trade is within the realm of damages, not accounting.

Judge Moore, concurring and dissenting, agreed that the case should be reversed and remanded for an accounting, but suggested that the trial court should also re-examine the finding of no damages in light of the appellate court's elimination of the direct competition requirement. Judge Moore's point is this: perhaps the trial judge, over-impressed with the emphasis on direct competition, simply did not consider other types of injury which do not depend on a showing of competition. As an example, he argues that Monsanto has suffered a loss analogous to direct sales loss in that it has lost the profits it would have made had Perfect Fit's mattress pads been composed of one hundred per cent Acrilan as advertised, and that Perfect Fit should be required to compensate Monsanto for this loss.⁸⁹ Judge Moore's suggestion will assume great importance if the restitu-

⁸⁰ Rich, *Trademark Problems As I See Them—Judiciary*, 52 *Trademark Rep.* 1183, 1186 (Nov. 1962).

⁸¹ *Supra* note 15.

⁸² *Supra* note 6.

⁸³ *Supra* note 5.

⁸⁴ *Supra* note 14.

⁸⁵ 193 F.2d 77 (2d Cir. 1951).

⁸⁶ *Id.* at 82.

⁸⁷ *Supra* note 1, at 395-96.

⁸⁸ *Id.* at 397.

⁸⁹ *Id.* at 397. Since Monsanto did attempt to prove damages that do not depend

tion theory is adopted by the other circuits. Since the plaintiff will in all likelihood receive adequate compensation by way of an accounting, the direct competition rule can be placed in its proper perspective. That is, direct competition is relevant only to the consideration of one type of damages (direct sales loss), and even here competition should not be the exclusive consideration because it is possible to show a loss analogous to direct sales loss that does not depend on competition.

Despite the unfortunate language, the majority decision in *Monsanto* is significant for the following reasons:

(1) The decision specifically adopted the restitution approach to accounting as the law of the Second Circuit. It may induce other circuits, as yet unclear on accounting, to follow the Second Circuit's analysis, thus resulting in a uniform statement of accounting in federal trademark cases.

(2) Since, under the restitution theory, the trademark owner need prove only unauthorized use by the infringer, a greater number of accountings will be awarded, and the owner's interest in the exclusive use of his mark will be more adequately protected. The owner will receive a money compensation and such blatant commercial piracy as was practiced in the *Monsanto* case is likely to be deterred.

(3) The opinion refers to the language of the Lanham Act and gives it a fair interpretation—one that is long overdue in the federal courts. The broad provisions of section 35 provide all the authority needed to eliminate the direct competition as it is applied to accounting.⁴⁰

(4) The court stated that public policy demands that this type of fraudulent conduct be prevented. The individual consumer invests only a small amount of money in a mattress pad and is unlikely to seek a remedy in court when he discovers that the product is not what it seemed to be. Since there are no criminal sanctions in federal trademark law and since damages are so difficult to prove, the liberal use of accounting is the only available deterrent. In *Monsanto*, it appears that this consideration of public policy was a very important factor in the decision, although the primary purpose of the restitution theory is to restore the profits gained from the infringement to their rightful owner, and not to protect the public from fraud.

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on competition (Brief for Plaintiff, pp. 18-19), it seems probable that the Judge did consider this type of damages.

⁴⁰ S. Rep. No. 1333, 79th Cong., 2d Sess. (1946), reported in U.S. Code Cong. Service 1274:

The purpose of this bill is to place all matters relating to trade-marks in one statute and to eliminate judicial obscurity, to simplify registration and to make it stronger and more liberal, to dispense with mere technical prohibitions and arbitrary provisions, to make procedure simple, and relief against infringement prompt and effective.