

Federal Court



Cour fédérale

Date: 20170313

Docket: T-2149-14

Citation: 2017 FC 274

Ottawa, Ontario, March 13, 2017

PRESENT: The Honourable Mr. Justice Manson

BETWEEN:

**FRAC SHACK INC. and FRAC SHACK
INTERNATIONAL INC.**

**Plaintiffs/
Defendants by Counterclaim**

and

AFD PETROLEUM LTD.

**Defendant/
Plaintiff by Counterclaim**

PUBLIC SUPPLEMENTAL JUDGMENT AND REASONS

I. Introduction and Issues

[1] In 2017 FC 104, the Court directed the Defendant (“AFD”) to pay to the Plaintiffs (“Frac Shack”) (1) the gross profits made by AFD, from September 24, 2014 to December 13, 2014, from the rental of the AFD Frac Trailer, not including the profits associated with fuel sales (at

para 313); and (2) reasonable compensation for use of the AFD Frac Trailer prior to September 24, 2014, the issue date of the '567 Patent.

[2] The Parties have come to an agreement regarding the amount of reasonable compensation: **\$126,037**.

[3] The Parties are in disagreement regarding the amount of gross profits that are to be paid by AFD to Frac Shack. The gross profits are to be calculated based upon the following (at para 308):

- a. including the rental days in September, calculated based upon the formula proposed by Mr. Harington; and
- b. calculating depreciation based upon an expected economic life of the AFD Frac Trailer of eight years, using the “declining rate” method proposed by Mr. Harington.

A. *Issues*

[4] The issues to be determined are:

- A. Which accounting method did the Court intend to be used to do the depreciation calculation?
- B. What monetary value should Frac Shack be awarded as an accounting of profits for AFD's use of the AFD Frac Trailer after September 23, 2014?

B. *Results*

[5] The results are:

- 1) The accounting method the Court intended to be used was the “sum of the digits” method.
- 2) Frac Shack is awarded **\$221,786** as an accounting of profits—which is AFD's gross profits, inclusive of pre-judgment interest, calculated using the “sum of the digits” method, assuming the AFD Frac Trailer has an eight year economic life—and **\$126,037** as reasonable compensation, inclusive of pre-judgment interest.

II. Submissions of the Parties

[6] At paragraph 307 of the Judgment and Reasons, the Court noted that the method proposed by Mr. Harington was to “depreciate the AFD Frac Trailer according to the ‘declining rate’ or ‘sum of the digits’ method”.

[7] In Mr. Harington’s original expert affidavit he stated that it was his opinion that “for machinery and equipment generally, a ‘declining rate’ or ‘sum of the digits’ method provides a more reasonable estimate for the purpose of computing profits ...” (Harington affidavit at paragraph 52). Subsequently, Mr. Harington described the “declining balance” method, explaining that the challenge with the “declining balance” method is that the carrying value never actual gets to zero, and suggested that to get to zero the appropriate method was the “sum of the digits” method.

[8] AFD argues that the correct interpretation of paragraph 52 of Mr. Harington’s affidavit is that the “declining rate” and “declining balance” method are the same, and are different from the “sum of the digits” method. Further, AFD asserts that the use of 30% as the depreciation rate in Mr. Harington’s affidavit was exemplary, and that the actual depreciation rate needs to be calculated according to the formula:

$$\text{Depreciation} = 1 - (\text{scrap value}/\text{cost})^{1/n}, \text{ where } n = \text{the economic life of the asset in years.}$$

[9] Based upon this formula, using a scrap value of [redacted], and an initial cost of [redacted] the depreciation rate would be 54%. Using this depreciation rate and starting

depreciation on January 1, 2014, the gross profits payable to Frac Shack are \$121,988, inclusive of pre-judgment interest.

[10] Frac Shack argues that the “sum of the digits” method should be used to calculate the gross profits payable to Frac Shack for three reasons:

- 1) Mr. Harington used the “sum of the digits” method in his analysis. This is the depreciation method he presented to the Court in his report and what he used to calculate Schedule 4 to his affidavit. The “sum of the digits” method results in a “declining rate” of depreciation per year.
- 2) AFD’s closing submissions at trial treated the “sum of the digits” method and the “declining balance method” to be equivalent (at paragraphs 28 to 32 of AFD’s memorandum on remedies):

Accordingly, AFD submits that the proper method of determining depreciation is a declining balance method ...

Using a declining balance method and a lifetime of 5 to 6 years, Harington determined that the AFD profits were \$196,523 as a midpoint estimate. As a reasonableness check, Harington determined that the profit (*sic*) of AFD using the income tax amortization rate of 30% was \$199,359.

Accordingly, AFD submits that its profits from the use of the AFD trailer in the entirety of the post-grant period was (*sic*) \$196,523.

- 3) Mr. Harington provided no basis in his report or at trial by which the yearly rate of depreciation could be calculated for the “declining balance” method using an eight year (or any number of year) economic life of the AFD Frac Trailer.

[11] Further, Frac Shack asserts that, if the Court finds that the “declining balance” method should be used, AFD cannot now argue that the rate of depreciation should be higher than the 30% Mr. Harington applied at trial. In the alternative, if the Court finds that the “declining balance” method and depreciation rate of 54% is appropriate, Frac Shack submits that the appropriate date to begin depreciation is June 1, 2013, not January 1, 2014.

III. Analysis

[12] Based upon the expert evidence, there is no depreciation method that is called “declining rate”. The three depreciation methods that were before the Court at trial, therefore, were “straight line”, “sum of the digits”, and “declining balance”.

[13] In the affidavit submitted to the Court for this determination, Mr. Harington states that, in his original expert affidavit, he intended the terms “declining rate” and “declining balance” to be synonymous. Upon review of his original affidavit, I do not find that this intention was clearly expressed. However, it is clear from his original affidavit that he is suggesting that the “sum of the digits” method is the appropriate method to use to calculate the depreciation of the AFD Frac Trailer.

[14] The fact that Mr. Harington was not clear about the differences between the “sum of the digits”, “declining rate”, and “declining balance” methods is evinced by AFD’s closing submissions, where AFD conflated the “sum of the digits” and the “declining balance” methods.

[15] Further, the calculation of the amount of profits to be disgorged, in the Schedules to Mr. Harington’s original affidavit, was done using the “sum of the digits” method and his calculation using the “declining balance” method was put forward as a reasonableness check on the amount of gross profits he arrived at through the “sum of the digits” method.

[16] The plain language interpretation of the wording of paragraph 307 of the Judgment and Reasons is that the “declining rate” method and the “sum of the digits” method are the same. Given that “declining rate” is not a method of depreciation, it is reasonable to infer that, in directing the Parties to use the “declining rate” method, the Court meant that the mathematical formula for the “sum of the digits” method would be used to arrive at a gross profits amount based upon an eight year economic life.

[17] Therefore, I find that it is appropriate to calculate AFD’s gross profits according to the “sum of the digits” method, using an eight year economic life, which results in an amount of **\$221,786.**

JUDGMENT

THIS COURT'S JUDGMENT is that:

1. The accounting method to be used is the “sum of the digits” method.
2. Frac Shack is awarded **\$221,786** as an accounting of profits—which is AFD’s gross profits, inclusive of pre-judgment interest, calculated using the “sum of the digits” method, assuming the AFD Frac Trailer has an eight year economic life—and **\$126,037** as reasonable compensation, inclusive of pre-judgment interest.

"Michael D. Manson"

Judge

FEDERAL COURT

SOLICITORS OF RECORD

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**PUBLIC SUPPLEMENTAL
JUDGMENT AND REASONS:** MANSON J.

DATED: MARCH 13, 2017

APPEARANCES:

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