# Are directors personally liable for breaches of intellectual property rights by their companies?

*Ben Cain & Dr Shayne Nam – James & Wells Intellectual Property*

It is a misconception that company directors enjoy the benefit of limited liability for their actions as directors. As a number of recent decisions in the IP field illustrate, the converse is actually true – directors 'enjoy' unlimited liability. Those clients holding the status of director need to make sure that they take appropriate precautions, some of which are discussed below.

**Introduction – the concept of limited liability**

There are two well known foundation concepts in company law:

- first, that a company is a separate legal entity to its director(s)[1]; and
- second, that incorporation of a company provides limited liability.

What isn't so well known is that, except where a company's constitution provides otherwise, limited liability is strictly the preserve of shareholders, and then only:

- in relation to a company's financial obligations; and
- provided those shareholders are not acting as *de facto* directors.[2]

A shareholder does *not* enjoy limited liability to a company for any tort (civil wrong), or breach of fiduciary (good faith) duty, or other actionable wrong committed by the shareholder.[3] Directors and shareholders, then, may still be found personally liable for civil wrongs they commit while working for the company. Company directors in particular have no more protection from liability than anyone else when they commit civil wrongs in the course of company business.[4]

The issue of director liability can especially affect small to medium enterprises where often there are one or two shareholders who are also directors. Over 85% of New Zealand companies are companies with two or less shareholder-directors, a situation which is mirrored across NPNZ members.[5] There is consequently a significant danger that if company A somehow infringes the IP rights of company B, company B will decide to take issue not just with company A but also with one or more of company A's directors for their involvement in the alleged infringing activity.

**Establishing directors' personal liability for breaches of IP rights**

There are two ways in which a director will be found personally and jointly liable with their company for breaches of IP rights:

1. Under the specific provisions of the relevant statute; and/or
2. Under the principles of common law.

This paper focuses on the common law: an area of significant interest following a recent High Court decision concerning copyright infringement by a director (*Inverness Medical Innovations, Inc and Anor v MDS Diagnostics Limited and Anor*.)[6]

### *Inverness Medical Innovations v MDS Diagnostics Limited*

*Background facts*

In 1998, a Dr Appanna recognised an opportunity in New Zealand to sell pregnancy test kits to PHARMAC for a much cheaper price than the incumbent supplier. On 4 November 1999 MDS was incorporated to exploit this opportunity, with Dr Appanna the sole director. Two further directors were appointed in July 2000: the company's accountant and the company's solicitor.

Dr Appanna was the principal participant in the business, responsible for sourcing product from overseas. He was, as the Court observed,[7]:

> …a person with considerable experience, competence and intelligence to enable him to make relevant appraisals of, and reach relevant conclusions in respect of, the competing products he had knowledge of. This was made clear from Dr Appanna's own evidence as to his experience as a medical general practitioner, his dealings over an extended period of time with pregnancy testing products, and his competence in investigating and understanding technical matters relating to these products.

In November 1999, MDS began importing and selling pregnancy testing devices in New Zealand. In 2006, Inverness alleged that that the importation and sale of the MDS devices infringed their copyright and subsequently sued MDS and Dr Appanna for breach.

*Liability under the principles of common law*

The Court applied two tests to Dr Appanna's actions: first, did he direct or procure the infringing acts; and, second, in the alternative, did he make the wrongful (tortious) acts of the company his own? The Court decided 'yes' under both tests.

As to directing and procuring the infringing acts, the reasons the Court cited were[8]:

1. All of the critical decisions relating to infringement of copyright were decisions made by Dr Appanna and by him alone. Although there was evidence of proper corporate governance, there was no evidence of any contributory involvement by either or both of the other two directors or any of the employees of the company in these decisions.
2. All of the primary decision making activities of MDS, from the selection of products through to the critical marketing activities in New Zealand, were plainly Dr Appanna's areas of responsibility and within his special expertise. There is no evidence that the other directors of MDS had any requisite expertise, nor was there evidence of any relevant involvement by employees. All relevant activities were controlled personally by Dr Appanna.

As to making the wrongful acts his own, the Court was satisfied that Dr Appanna personally and deliberately associated himself with the relevant acts of MDS by, for example, personally endorsing MDS's products in public promotions, and by being the registered owner of trade marks for the MDS products.

**Summary/Advice**

Although not explicitly set out by the Court in *Inverness*, it appears from a number of UK cases dealing with director liability (in particular the 2002 UK copyright infringement case of *MCA Records Inc v Charly Records*[9]), that, under the common law, a director will be held personally and jointly liable with his/her company for a breach of IP rights if a director cumulatively does four things:

1. Goes beyond his/her normal, constitutional role as a director in the governance of the company; and
2. Intends to infringe another person's IP rights; and
3. Participates in, or directs or procures or induces another to commit, an infringing act (of which the company might itself be the "other"); and
4. Shares a common purpose or design with the company to infringe a statutory right. Procurement of an infringing act under (3) may lead to a common design and so give rise to joint liability.

These factors are of course determined on a question of fact by the Court.

In order to avoid similar findings, directors and companies need to establish sound business practices to assist in any commercial decision making process.

The obvious starting point is to try to avoid infringing the rights of others in the first place which means being aware of the sorts of rights your competitors may possess. This may involve conducting research to establish whether or not certain intellectual property rights exist for any products/processes in your field of interest, and more importantly, maintaining a watch on your competitors' IP activities by updating that search on a regular basis.

However, no matter how vigilant you are (innocent) infringement remains a possibility. There are a few pragmatic steps you can take to minimise the prospect of personal liability. These include:

- Holding directors meetings on a regular basis and in accordance with accepted standard practice (for example, by producing an agenda of items to be discussed, appointing a chair for each meeting, making notes at the meetings and producing minutes which record the nature of any discussion and the decisions made);

- Recording and documenting all essential company decisions; and

- Ensuring that all directors are involved in the decision making process (even if the decision falls within the area of expertise of one specific director); and

- Taking heed if your company receives a cease and desist letter alleging that your company's activities are infringing the rights of others. It is often best to stop the alleged infringing activity, but as a minimum you should seek competent legal advice.

Another measure that can be taken to mitigate personal loss is to take out directors' and officers' liability insurance. D&O liability insurance protects the directors, officers and senior managerial staff in your company against claims arising from their actions and decisions whilst carrying out their duties associated with the management of the company. However, it is important to note that liability insurance policies generally only cover wrongful acts committed by directors and officers acting in their official capacities. As with any insurance policy, any perceived coverage should be clarified with the relevant insurance agents.

**Conclusion**

Directors can be jointly liable for breaches of intellectual property rights by their companies. If you are concerned about whether or not your company's products or processes may breach the intellectual property rights of others, it is well worth seeking professional advice from a specialist intellectual property law firm prior to making any commercial decision when launching your own product line or manufacturing process. This is something we can assist you with.

In addition, it is worth considering taking out D&O insurance and/or statutory liability insurance to safeguard oneself from having to delve deep into your own pockets should you be unfortunate enough to be found personally liable for breaching a company's IP rights.

Please feel free to contact us for further information on Patent Searching and Competitor Watch services, representation in IP infringement actions and D&O / Statutory Liability insurance.

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*Ben Cain: Ben is a solicitor in the Litigation team based in our Auckland office. Ben has a Bachelor of Laws with First Class Honours from the University of Waikato, as well as a BA (Hons) and MSc in International Marketing from universities in the UK. At the University of Waikato Ben won a number of academic prizes including the prize in Intellectual Property Law in 2009 and the Waikato Bay of Plenty District Law Society and Auckland District Law Society prizes for top honours graduate in 2009. Before turning to the Law, Ben enjoyed a 15-year career in marketing and design in the UK and New Zealand, including eight years working extensively in new product development across a diverse range of consumer goods industries. If you have any queries regarding copyright or trade marks, Ben can be contacted by email on: benc@jaws.co.nz*

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[1] Section 15 Companies Act 1993.
[2] Section 97(1) and 97(2) Companies Act 1993.
[3] Section 97(3) Companies Act 1993.
[4] Personal Liability – No Special Immunity For Directors: Law Link Summer 2008 *<http://www.lawlink.co.nz/articles.php?articleid=121.>*
[5] Ibid.
[6] *Inverness Medical Innovations, Inc and Anor v MDS Diagnostics Limited and Anor* 24/6/10, Woodhouse J, HC Auckland (CIV 2007-404-748).
[7] Ibid at [276].
[8] Ibid at [298]-[300].
[9] *MCA Records Inc v Charly Records* [2002] FSR 401, subsequently successfully applied in *WebSphere Trade Mark* [2004] EWHC 529 (Ch); [2004] FSR 39 (regarding trade mark infringement) and *Boeglie-Gravures S.A. v Darsail-ASP Ltd & Pyzhov* [2009] EWHC 2690 (Pat) (regarding patent infringement). See also the New Zealand case of *Winchester International (NZ) Limited & Anor v Cropmark Seeds Limited* [2005] NZCA 301 (CA) (regarding infringement of the Plant Variety Rights Act 1987).

Courtesy of James & Wells Intellectual Property