SLAUGHTER AND MAY/

IP CLIENT BRIEFING

Knowledge essential: UK Supreme Court considers directors' accessory liability and account of profits

JUNE 2024

/ INTRODUCTION

'Could I be personally liable for the wrongdoing of my company?' is a question which all directors have no doubt contemplated at one time or another.

This question was at the heart of the Supreme Court's recent judgment in *Lifestyle Equities v Ahmed [2024] UKSC 17*, in which the Supreme Court considered the circumstances in which a director could be found liable as an accessory for a strict liability tort, such as trade mark infringement, that has been committed by their company.

In this briefing, we take a closer look at what the *Lifestyle Equities* case was about and discuss the key takeaways from the Supreme Court's conclusions.

TRADE MARK INFRINGEMENT AND STRICT LIABILITY

UK trade mark infringement is an example of a 'strict liability' tort. Strict liability torts do not require the person committing the tort to have had any particular state of mind to be found liable. Trade mark infringement can be committed even though the defendant was not at fault and is unaware that their actions constitute trade mark infringement, provided those actions: (i) fall within the scope of the infringing acts listed in the Trade Marks Act 1994; and (ii) were carried out without the trade mark owner's consent.

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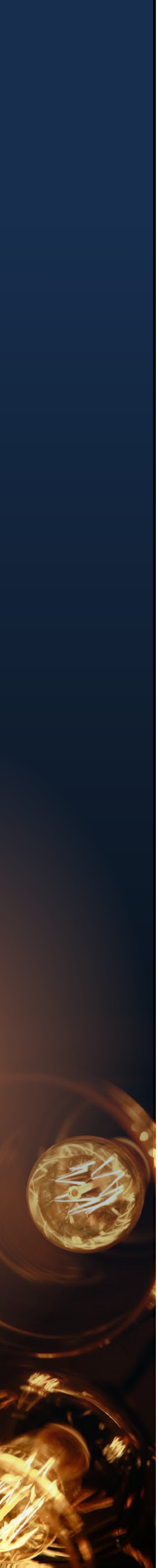

WHAT WAS THE CASE ABOUT?

Lifestyle, the claimants in the case, own a number of registered UK and EU trade marks which include the words "Beverly Hills Polo Club" and certain devices based on horse-riding polo players. They brought proceedings for trade mark infringement and passing off against 16 defendants, including two family-owned companies (Continental Shelf 128 Ltd and Hornby Street Ltd) which traded under the name "Juice Corporation". Juice Corporation sold various items of clothing and footwear which displayed the name "Santa Monica Polo Club" and pictures of polo players on horses. The defendants also included two siblings – Mr and Ms Ahmed. Both were directors of Hornby Street. Mr Ahmed was also the sole director of Continental Shelf.

Lifestyle alleged (amongst other things) that the Juice Corporation companies' use of the Santa Monica Polo Club branding infringed their UK trade marks under sections 10(2) and 10(3) of the Trade Marks Act 1994. They also alleged that Mr and Ms Ahmed were themselves liable as accessories on the basis that they had authorised or procured the Juice Corporation companies to carry out the infringing acts or engaged in a "common design" to cause the companies to act in such a way.

At first instance, the High Court agreed with Lifestyle, finding that Hornby Street had infringed Lifestyle's marks under sections 10(2) and 10(3) and had committed passing off. It also later determined that the Ahmeds themselves were jointly and severally liable with Hornby Street for those infringements.

Infringement having been found, and with the Juice Corporation companies having become insolvent, Lifestyle chose to claim an account of profits against the Ahmeds, seeking both the profits the Ahmeds had personally made from the infringements, as well as the profits made by Hornby Street. The High Court rejected Lifestyle's claim that the Ahmeds should account for Hornby Street's profits but agreed that they should be required to account for their own personal profits. And it apportioned 10% of their salaries during the relevant period, as well as a loan made by Hornby Street to Mr Ahmed, for these purposes.

Both parties appealed - Lifestyle appealing the High Court's finding that the Ahmeds were not liable to account for Hornby Street's profits; and the Ahmeds appealing: (i) the High Court's finding that they were jointly liable for Hornby Street's infringements; and (ii) the finding that they had made any profits for which they were liable to account to Lifestyle. These appeals were largely dismissed, save that the Court of Appeal found that the loan made to Mr Ahmed should not be treated as a profit for these purposes.

Both parties then subsequently appealed to the Supreme Court, with the two central issues being:

1. Accessory liability: when are directors of a company liable as accessories for causing that company to commit a tort of strict liability such as trade mark infringement? Is such accessory liability also strict or does it depend on the director's knowledge (or some other mental element)?

2. Account of profits: where a director is found jointly liable for trade mark infringement, how should the remedy of account of profits be applied? Does a director need to have acted unconscionably or in bad faith in order for an account of profits to be awarded? Whose profits are relevant? And what should be treated as "profit" for these purposes?

ACCESSORY LIABILITY

Lifestyle relied on two separate common law principles for arguing that the Ahmeds were liable as accessories. Firstly, that the Ahmeds had authorised or procured Hornby Street to commit trade mark infringement. Secondly, that they had participated in a common design to commit trade mark infringement.

The parties were not in dispute that, as a matter of causation, the Ahmeds' actions did indeed induce Hornby Street to infringe Lifestyle's trade marks. But there was disagreement about:

- whether there are any special rules that protect directors from accessory liability in this sort of scenario; and
- the mental state required for accessory liability – in particular, whether accessory liability will be strict where the underlying tort (e.g. trade mark infringement) is one of strict liability.

On the first point, the Ahmeds claimed that they, as directors, should be subject to special rules – they argued that provided they were acting properly in the performance of their directors' duties and without knowing that Hornby Street was acting unlawfully, all of their actions should be attributed to Hornby Street and they should not be held jointly liable. The Supreme Court disagreed, finding that, in the context of a claim for IP infringement, there is no principle of English law which exempts directors from the ordinary principles of tort liability.

As for the second point, the Supreme Court found that the mental state required for accessory liability does not need to be the same as that for the primary tort. Instead, to be jointly liable as an accessory for a tort, under either principle of accessory liability, a director must know (or deliberately turn a blind eye to) the "*essential facts which make the act unlawful*" – even if the primary tort itself (e.g. trade mark infringement) requires no particular knowledge. The Court was clear that this does not mean that a particular defendant must have sufficient knowledge of the law to know that any particular act will be unlawful (ignorance of the law can be no excuse), but rather that they are aware of all the features which make the act of the primary wrongdoer unlawful.

Applying this to the case before it, the Supreme Court concluded that the Ahmeds did not have the necessary knowledge for accessory liability. In particular, it noted that this was not a case relating to counterfeit goods, where Lifestyle's marks had been slavishly copied and used on identical goods - the signs used by Hornby Street were different to Lifestyle's marks and there was room for argument and "honest difference of opinion" about the extent of similarity between them and whether it was sufficient to give rise to infringement.

Whilst the Supreme Court noted that the trial judge, at first instance, had made certain findings about the Ahmed's knowledge, it concluded that those findings fell "well short" of the standard required. For example:

- the trial judge did not find that the Ahmeds knew, or should have appreciated, that there was a likelihood of confusion between the "Santa Monica Polo Club" signs and Lifestyle's "Beverly Hills Polo Club" trade marks;
- it was not submitted by Lifestyle that the Juice Corporation companies and their directors deliberately intended to take unfair advantage of Lifestyle's marks; and
- whilst the trial judge found that the Ahmeds must have known about the reputation of Lifestyle's marks from 2014 (when they received a letter of complaint from Lifestyle), he did not find that the Ahmeds knew or should have appreciated that that reputation would be adversely affected by Hornby Street's use of the Santa Monica Polo Club signs.

As a result, the Supreme Court overturned the decisions of the lower courts, concluding that the Ahmeds were not jointly liable with Hornby Street for infringing Lifestyle's trade marks.

ACCOUNT OF PROFITS

Notwithstanding its finding that the Ahmeds were not liable, the Supreme Court went on to consider and answer various questions relating to the remedy of account of profits – in part because its views on some of those questions differed from those of the Court of Appeal. Whilst obiter, these comments will no doubt have significant persuasive effect and will very likely be followed by the lower courts in future.

As readers may well be aware, a successful claimant in UK IP infringement proceedings will have the right to elect between the remedies of damages and an account of profits (in addition to other remedies, such as an injunction, that might be sought). If an account of profits is chosen, the defendant will be required to return the profits they have gained from their wrongdoing to the claimant. So far, so good. But the rules relating to an account of profits were not as clear as they could have been. Fortunately, the Supreme Court took up the opportunity to address the issues before it, including: whether it is appropriate to order an account of profits when the infringer is "innocent"; whose profits should be accounted for; and whether a loan or a proportion of salary can constitute 'profit' for these purposes.

Can an account of profits be ordered against an innocent infringer?

In a nutshell, yes. The Supreme Court made it clear in its judgment that knowledge is not relevant to determining whether an account of profits should be awarded. One of the key purposes of intellectual property rights is to "*encourage and reward creativity and innovation by enabling the owner of the right to enjoy the fruits of its exploitation*". The court found that allocating profits made by an infringer, innocent or otherwise, promotes that purpose. As a result, where an IP right is infringed, it is justifiable that the infringer is required to return any profits from the infringement to the rightsholder, even where that infringer has not acted unconscionably or in bad faith.

Whose profits are relevant?

As for whose profits are relevant, the Supreme Court agreed with the Court of Appeal that a person should only be required to account for profits they themselves have made, and not those made by another. As the court highlighted, the purpose of an account of profits is not to punish the defendant, but rather to ensure that profits they made as a result of the infringement are transferred to the claimant. Ordering an infringer to account for a co-defendant's profits would go beyond this and be equivalent to imposing a penalty or a fine. As a result, the Supreme Court agreed with the lower courts' conclusions that the Ahmeds should not be liable to account for Hornby Street's profits.

Should loans or salaries be treated as profit?

That left the court to consider what profits the Ahmeds themselves may have personally made from the infringements. In particular, could a proportion of their salaries or the loan made by Hornby Street to Mr Ahmed count as profits? The Supreme Court concluded that neither could be treated as profits in this case.

Starting with the loan, the Supreme Court agreed with the Court of Appeal that it would be wrong in principle to treat this as a profit – a person does not make a profit simply by borrowing money. According to the court, that remains true even where the loan is subsequently forgiven or otherwise ceases to be repayable. However, the court did acknowledge that in some cases it may be possible to argue that a loan gives rise to a profit. For example, if the loan is interest free or at a lower rate of interest than a commercial rate, then the difference might generate a profit; or a "loan" might be treated as profit if it can be shown that it was really a disguised dividend.

The Supreme Court disagreed, however, with the Court of Appeal on the question of salaries, finding that the salaries paid to the Ahmeds (or a proportion of them) should not be treated as profits. Lord Leggatt reasoned that an employee who receives money in return for services at fair market value is not making a profit and so should not be required to account for any of their salary. As with loans, the court indicated that there may be occasions when payment of a salary might be seen as a way of extracting profits, but this was not such a case.

COMMENT AND PRACTICAL TAKEAWAYS

This is an important decision which clarifies not only the circumstances in which directors could be found jointly liable for the tort of trade mark infringement, but also more general principles of accessory liability and the law relating to an account of profits. Although the outcome of cases such as this are naturally fact dependent, there are a number of broader points we can take away from this decision.

- Accessory liability for strict liability torts requires knowledge: we now know that knowledge of the "essential facts which make the act unlawful" is required for directors to be found liable as accessories in respect of strict liability torts such as trade mark infringement. However, whilst the Supreme Court has given some guidance, it remains to be seen what the "essential facts" will be for any particular tort and when an alleged accessory may be regarded as having "turned a blind eye" to those facts. In an IP infringement context, it appears that establishing the required knowledge may be easier in cases relating to counterfeit goods, but could prove difficult in other cases.

- Evidence is key: whether a director is liable in any particular case will be very fact dependent and therefore evidence will be critical. Claimants who are seeking to establish accessory liability for directors would be wise to allege (and put forward supporting evidence to show) that such directors knew, or should have appreciated that, their company was engaging in infringing activity. One proactive step claimants could take to assist with this would be to expressly put directors on notice of their rights at an early stage (although, in an IP infringement context, care would need to be taken to avoid falling foul of the rules on unjustified threats).

- Beware indirect IP infringement: whilst infringement under section 10 of the Trade Marks Act 1994 does not include "authorising or procuring" another person to infringe (hence the need for accessory liability to be established on the basis of the common law), the position is not the same for all IP rights. For some IP rights, the legislation itself provides for indirect infringement. Under section 16(2) of the Copyright, Designs and Patents Act 1988, for example, copyright is infringed by "*a person who without the licence of the copyright owner does, <u>or authorises another to do</u>, any of the acts restricted by copyright*". As a result, if a director authorised an employee to infringe copyright, that director would be liable under section 16(2), and there would be no need to consider whether they were aware of the essential facts which made that act unlawful.

- Take care when electing for damages or an account of profits: given the Supreme Court's findings on whose profits can be taken into account and what may be treated as "profits" in the context of a claim for accessory liability against a director, careful consideration should be given as to whether electing for an account of profits is the correct approach in any given case or whether damages would be the more advantageous remedy.