

Does a sub-licence continue after its head licence terminates? A comparison of the German and UK positions

By partner Luke Kempton, and associate Peter Koch, in Wragge & Co's Intellectual Property team

The German Federal Court (Bundesgerichtshof, BGH), the highest civil court of last resort in Germany and so with a similar status to the UK's Supreme Court, has handed down two decisions which preserved the validity of a sub-licence upon the termination of the head licence. The decisions are in line with one the court made in 2009 on the same issue.

The court reached its decision on the basis that each sub-licensee had made investments based on its licence. It also considered that as the sub-licensees could not influence or foresee early termination of the head licence, they should therefore have the right to continue using the intellectual property rights concerned under the terms of the sub-licence. However, while the sub-licence continues, any royalty payments made by the sub-licensee will be paid to the head licensor rather than to the head licensee.

The decisions contrast with the generally accepted UK position whereby a sub-licence terminates at the same time as the termination of the head licence. Wragge & Co's German and UK IP experts have prepared an analysis of the UK position and some useful action points to consider.

The recent decisions of the BGH

The German Federal Court (Bundesgerichtshof, BGH), the highest civil court of last resort in Germany and so with a similar status to the UK's Supreme Court, has handed down two decisions which preserved the validity of a sub-licence upon termination of the head licence. The decisions are in line with one the court made in 2009 on the same issue.

The court reached its decisions on the basis that each sub-licensee had each made investments based on its licence. It also considered that as the sub-licensees could not influence or foresee early termination of their respective head licences, they should therefore have the right to continue using the intellectual property rights concerned under the terms of the sub-licence.

However, while the sub-licence continues between the head licensee and the sub-licensee, any royalty payments made by the sub-licensee will be paid to the head licensor rather than to the head licensee. This results from a provision of the German Civil Code and means that the head licensee will have to continue to perform the sub-licence without receiving payment from the sub-licensee.

Although not dealt with in the judgments, it is assumed that the court's decision would not extend to a sub-licence whose head licence has expired through effluxion of time and that the validity of a sub-licence continues only where the main licence terminates prematurely. While the cases referred to the court both concerned the licensing of copyright, the court also made it clear that its decisions would

apply equally to the sub-licensing of other intellectual property rights. The chamber of the BGH that is responsible for patent law was not directly involved in this decision but has confirmed it stands in agreement.

UK position - termination of sub-licence

It is often expressly stated in licence agreements that where sub-licensing is permitted, all sub-licences granted shall terminate automatically on termination or expiry of the main licence agreement. Sometimes licences state that any sub-licensee shall first enter into a supplemental agreement direct with the licensor, which gets around the privity of contract rule and ensures certainty in the event of termination of the main licence. But where this is not the case, what is the default position in the UK?

The basic proposition is set out in a 1925 case, *A Baldwin & Co Ltd v Magnetic Car Co Ltd (1925)*. This confirmed (in the context of patent sub-licensing) that a sub-licence will normally terminate at the same time as the head licence terminates, unless there is a provision to the contrary. It was held in this case that:

- the relationship of the parties would be determined by the contract they had entered into;
- the sub-licensee was likely to have known the extent of the provisions under which the head-licensee had purported to grant the sub-licence; and
- none of the parties had contemplated that if the licence terminated the licensor was subject to obligations created in favour of a sub-licensee.

While case law on the subject is limited, in the absence of an express provision to the contrary, it appears logical that where IP rights are licensed, any termination/expiry of the licence granting the rights to a sub-licensee would in turn render the sub-licence terminated at the same time. There would no longer be any rights capable of being licensed to the sub-licensee. The nature of a sub-licence means that it is reliant upon the flow down of rights from its licensor. Without such rights, it would infringe the owner's rights unless the sub-licensee subsequently gains the licensor's permission.

Where IP rights are licensed, the terms of the main licence agreement often support the position that (in the absence of provision to the contrary) a sub-licence should automatically terminate where the main licence terminates. Arguments which tend to support the position include the following:

- A licensor may have placed quality control obligations upon its licensee, who in turn places the same obligations on its sub-licensee. If the licence between the licensor and licensee was to terminate, the licensor would be unable to control quality if the sub-licence was to continue because there would be no contractual link between those parties. The continuation of use of IP rights under a sub-licence which was not subject to contractual controls could be detrimental to the reputation, validity and value of the owner's IP rights.
- The licensor's reason for licensing may be purely financial and without the existence of the main licence, there would be no direct right for the licensor to claim royalties from the sub-licensee. Royalties under the sub-licence would be payable to the party licensing the sub-licensee. The sub-licensee would not be obliged to make payments to the owner of the rights. Where the head licensee and sub-licensee are granted an exclusive licence of IP rights, it

cannot be correct that a sub-licence should continue on this basis, depriving the owner of valuable royalties and the ability to licence other parties. As mentioned above, in Germany this point is dealt with under the German Civil Code whereby the sub-licensee's payments are made to the head licensor, but there is no equivalent provision under English law.

- Often, the licensee under the main licence is liable to the licensor for all acts and omissions of any sub-licensee and indemnifies the licensor against all losses incurred or suffered by the licensor, or for which the licensor may become liable arising out of any act or omission of any sub-licensee. This could include product liability claims relating to any licensed product manufactured or supplied by the sub-licensee for example. If the head licence was to fall away, this would leave the licensor/owner exposed and potentially out of pocket.
- A licensee cannot licence rights it does not have and if a licensee's IP rights cease to exist, so must any rights it has licensed under a sub-licence. These rights and the terms of the sub-licence flow from the head licence.

In view of the privity of contract principles and the arguments outlined above, it would seem both logically inconsistent and detrimental to the IP owner for the default position to be the continuation of a sub-licence upon termination of the head licence. However, in light of the recent German decisions, there may be scope for this to be tested.

Arguments for preserving the validity of a sub-licence

US case law and commentary suggests alternative arguments for preserving the validity of a sub-licence on termination of the main licence, in line with the BGH's decisions in the two recent judgments. These arguments are along the following lines:

- It would be inequitable to deem a sub-licence revoked where the sub-licensee has invested in the performance of its sub-licence and abided by its terms. The sub-licensee should not be penalised because its licensor has failed to do likewise. A sub-licence is an independent contract which should not be capable of termination upon the termination of the main licence, unless specifically agreed. While this does not seem to be the approach taken in the UK (but is the line of reasoning used by the BGH recently), it is conceivable that there may be circumstances where it is persuasive on the facts.
- Another argument suggested in US commentary is that a sub-licence is essentially an agreement between the licensor and sub-licensee and therefore the validity of the sub-licence is unaffected by any termination of the main licence. Unless the agreement with the licensee provides otherwise, the sub-licence will continue despite the early termination of the licence agreement.

Conclusion

Old case law and the arguments above logically support the UK position that a sub-licence should terminate if the main licence comes to an end, but the BGH's decisions are at odds with the generally accepted position in the UK.

However, as the issue has not been adjudicated recently and in light of the recent German court decisions, sub-licensees and licensors are advised to consider the terms of their arrangements.

If you are a licensor and wish all sub-licences to terminate on the termination of the head licence, then in light of the German decisions this should be made explicit in the head licence. In addition, the head licence should clearly state that there is an obligation on the head licensor to include such provisions in all sub-licences. You may also try to obtain the right to approve all sub-licences to make sure that such a provision is indeed included.

On the other hand, if you are a sub-licensee wishing to ensure the continuation of your licence, then as the issue has not been adjudicated recently in the UK and in light of the recent German court decisions, you may have some arguments that it should continue if the sub-licence is silent on the point. That said, it is far better to expressly address the issue. This can be achieved in the head licence where the licensor agrees to step into the head licensee's shoes in respect of any sub-licensees. The licensor will usually only agree to this if the sub-licensee is not in breach of its sub-licence and the licensor will only take over the sub-licence to the extent that it reflects the terms of the head licence. It will not want to take on onerous obligations that the head licensor was happy to agree vis a vis its sub-licensee - for example, the supply of materials or R&D collaboration.

If such step-in rights are not included in the head licence then the sub-licensee will need to make the licensor a party to its sub-licence in order to ensure that it obtains this protection.

For more information, please contact:

Luke Kempton, partner, Wragge & Co, +44 (0)121 629 1834, luke_kempton@wragge.com

Peter Koch, associate, Wragge & Co, +49 (0)89 540 412030, peter_koch@wragge.com