

# Time to evaluate if you are still in control

Recent Federal Court of Justice decisions have held that the validity of a sub-licence is independent of that of the original licence. Rights holders should thus take action to remain in control of their intellectual property

In two recent decisions, the German Federal Court of Justice has held that a sub-licence agreement can survive the termination of the main licence agreement.

Consequently, owners of IP rights can no longer terminate the sub-licence chain deriving from the main licence agreement simply by terminating the main licence agreement. Rights holders would thus be well advised to take contractual precautions when drafting future licence agreements if they allow their licensees to sub-licence the IP rights at issue. Moreover, rights holders should re-evaluate existing licence agreements and make necessary amendments in order to reclaim control of their IP rights exploitation chain.

Although both judgments were issued by the First Civil Senate of the Federal Court, which is responsible for trademark, design and copyright law, the senate emphasised in each decision that the Tenth Civil Senate of the Federal Court, responsible for patent and utility model law, had, upon request, confirmed that it did not object to the decisions. The decisions are therefore applicable to all licence agreements (whether main or sub-licence), regardless of the nature of the IP right covered.

The following article reviews the Federal Court's decisions, explains the impact that these decisions will have on (sub-)licence agreements and considers the actions to take for existing and future licence agreements.

## ***M2Trade and Take Five***

On July 19 2012 the First Civil Senate of the Federal Court issued the judgments *M2Trade* (I ZR 70/10) and *Take Five* (I ZR 24/11). *M2Trade* concerned rights of use pertaining to computer programs. The claimant – the software developer – issued an exclusive licence to a licensee, which in

turn granted a sub-licence to the defendant – a subsidiary of the original licensee.

In June 2002 the claimant terminated the main licence, as the licensee had not paid royalties since February 2002. On July 1 2002, the licensee was declared insolvent. Despite the licence termination and the licensee's insolvency, the defendant did not comply with the claimant's request to cease use of the computer programs.

*Take Five* concerned music publishing rights pertaining to the famous music piece "Take Five" by composer Paul Desmond. In 1960 Desmond granted an exclusive licence to the California-based claimant, allowing the latter to publish "Take Five" worldwide. By means of a sub-publishing agreement, the claimant granted an exclusive sub-licence for the European music publishing rights to a third music publisher. The latter in turn sub-licensed the music publishing rights for Germany and Austria to the legal predecessor of the defendant.

In 1986 the claimant and its licensee mutually agreed to terminate their main licence agreement and every sub-licence agreement which may have been derived from this main licence. The defendant, however, was of the opinion that the mutually agreed-upon termination did not affect any subsequent sub-licence agreements, including its own pertaining to Germany and Austria.

In both judgments, the Federal Court dismissed the respective claim and held that sub-licence agreements survive the termination or expiration of the main licence agreement. The court explained that its decisions are based on a consideration of the principle of succession protection (*Sukzessionsschutz*) and a balance of the interests of rights holders and sub-licensees.

The principle of succession protection

is stipulated for all IP rights (Section 33 of the Copyright Act; Section 30(5) of the Trademark Act; Section 31(5) of the Design Act; Section 15(3) of the Patent Act; and Section 22(3) of the Utility Model Act). The principle states, among other things, that exclusive and non-exclusive licences remain in effect even if the owner of the licensed IP right changes due to an assignment of the IP rights in question. In the opinion of the court, the stipulation of this principle is indicative of the legislature's belief that the termination or expiration of a right of use shall not have an effect on derived rights of use. The court argued that it is the purpose of the succession protection principle to protect the licensee's faith in the granted licence, thus enabling such licensee to amortise its investments in, and in connection with, the licence agreement (*M2Trade*, 24; *Take Five*, 16).

In addition, the Federal Court held that the sub-licensee's interest in the continuance of the sub-licence agreement generally outweighs the rights holder's interest in terminating the complete sub-licence chain by terminating the main licence agreement (*M2Trade*, 25; *Take Five*, 18).

According to the court, the sub-licensee cannot affect the circumstances that lead to an (immediate) termination of the main licence agreement; nor is the sub-licensee aware in most cases that the grounds for an immediate termination exist prior to the termination. Consequently, the termination of the main or sub-licence agreement catches a sub-licensee unawares, which in turn could threaten the sub-licensee's existence – in particular, if the sub-licensee's business is dependent on the subject matter of the sub-licence agreement.

In conclusion, the court found that a dependence of the sub-licence agreement on the main licence agreement would result in

an unfair disadvantage for the sub-licensee.

To avoid ambiguity, the court expressly stated that the survival of the sub-licence agreement is to be assumed regardless of the cause of termination or expiration of the main licence agreement (eg, lack of use or delay in royalty payments).

Both decisions will have a significant impact on all existing and future sub-licence agreements, especially in light of the approval of the Tenth Civil Senate that the rulings apply to all forms of intellectual property. For sub-licensees, the decisions provide legal certainty regarding the continuance of their sub-licence agreements and the protection of investments in, or in connection with, the sub-licence agreement. They will also facilitate long-term financial planning.

However, the practical impact of the decisions may not become readily apparent to rights holders and sub-licensors. As the court held, the termination of the main licence agreement does not affect a sub-licence agreement deriving from the main licence agreement. Under German law, the rights holder does not automatically take the licensee's contractual place in the sub-licence agreement after termination of the main licence agreement. Hence, the licensee and sub-licensee remain contractual partners in the sub-licence agreement.

Accordingly, the rights holder gains neither influence nor a termination right regarding the sub-licence agreement – not even where the sub-licensee breaches obligations contained in the sub-licence agreement. The termination right remains with the licensee and sub-licensee.

Without any contractual revisions to the licence agreements, rights holders will have no other choice than to endure their loss of control over the sub-licensed IP rights.

For sub-licensors, the situation might become even more difficult: as the sub-licensor remains bound to the obligations of the sub-licence agreement, the sub-licensor might be unable to fulfil its contractual obligations under the sub-licence agreement, such as the obligation to develop sub-licensed software further.

#### Actions to consider

The above uncertainties can be averted by contractual arrangements, such as amending existing licence agreements, revising licence agreement templates for future licence agreements or concluding additional contracts that provide clarity in case of termination of the main licence agreement. Such arrangements may include the actions outlined below.



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#### Prior written consent

An rights holder can remain in control of the exploitation chain by allowing a licensee to issue sub-licences only under the condition of its prior written consent. Furthermore, the rights holder should give its consent only after receiving a copy of the sub-licence agreement to ensure that the following provisions are incorporated.

#### Running royalties

The main licence agreement should include a provision enabling the rights holder to claim outstanding royalty payments directly from the sub-licensee once the main licence agreement is terminated. Furthermore, the licensee should be obligated to include a corresponding provision in the sub-licence agreement. If this is not done, the rights holder will have to assert running royalties from the licensee on grounds of unjustified enrichment under Section 812(1)(2) of the Civil Code.

#### Contractual dependence

If the rights holder is certain that no continuance of the sub-licence agreement is desired once the main licence has been terminated, a provision could be incorporated in the sub-licence agreement expressly stating that the continuance of the sub-licence agreement is dependent upon the continuance of the main licence agreement.

#### Termination rights

It is also advantageous for the rights holder to impose an obligation on the licensee to terminate the sub-licence agreement if the main licence agreement ends. Alternatively, the sub-licence agreement could stipulate that the termination of the main licence agreement constitutes grounds for termination that the rights holder may exercise to terminate the sub-licence.

#### Further actions

##### Novation contract

A transfer of all rights, liabilities, duties and obligations by means of novation of the sub-licence agreement could be considered. Concluding such a contract may be beneficial for all affected parties, as on the one hand the rights holder regains control of the sub-licensed IP rights, while on the other hand the licensee will be relieved from its contractual obligations. Lastly, the sub-licensee might gain an advantage if the rights holders can perform certain contractual obligations that the sub-licensor cannot, such as maintaining a licensed computer program.

A novation contract requires, however, that all three parties (rights holder, licensee and sub-licensee) sign the contract.

##### Claiming running royalties

Having terminated the main licence agreement, the rights holder is entitled to claim running royalty payments that the licensee receives from the sub-licensee. The claim can be asserted on the basis of unjustified enrichment, as explained above.

While the *M2Trade* and *Take Five* decisions provide legal certainty for sub-licensors, the consequences and impact for rights holders and sub-licensors are not, as yet, completely assessable. In particular, it is unclear how the sub-licensor will be able fully to fulfil the sub-licence without the rights granted under the main licence agreement; nor how the rights holder will regain control of the sub-licensed IP rights. It is therefore crucial to observe closely the enforcement of these decisions, as well as further decisions of the Federal Court addressing the remaining issues as detailed above. [WTR](#)