

Sub-licences Underestimated and Overlooked?

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A recent software licensing case illustrates care is needed when setting the parameters for rights granted to a sub-licensor. Sub-licensors can only rightfully sub-license rights within the scope of the head-licence. In other words, the rights the subject of the sub-licence cannot go beyond the rights granted to the sub-licensor by the head-licence. As a consequence, many would probably assume that a sub-licence must automatically fall away when the related head-licence comes to an end. This is no longer (and probably never was) a safe assumption to make.

In *VLM Holdings Ltd v Ravensworth Digital Services Ltd*¹, the England and Wales High Court, at first instance², found that a sub-licence permitting the use of software had survived the termination of the related head-licence. This had severe consequences for the software owner as its attempts to further exploit the copyright following the termination of the head-licence were found to be inconsistent with the continuing sub-licence.

The case illustrates the impact that sub-licences can have on a rights owner's ability to freely deal with its rights and how important it is to fully define the scope of sub-licences in any licensing scenario which permits sub-licences.

Background

VLM Holdings, the plaintiff and copyright owner, had granted an informal, non-exclusive licence to its subsidiary and UK trading arm, VLM UK, to exploit the copyright subsisting in a software facilitating design and printing services (the *Software*). The Software enabled VLM UK's customers to design printing materials (such as brochures, leaflets and business cards) on the VLM UK website, and then send these off for printing (usually to VLM UK's printers).

Spicerhaart, a real estate agency, was one of VLM UK's biggest customers and heavily relied on the Software to design and print its property brochures. However, Spicerhaart frequently experienced service delays and other problems caused by VLM UK's servers or printers being down or internet connection issues. Eventually, two things were done to improve the service. Firstly,

Spicerhaart entered into a contract with a third party printing service provider, Ravensworth, to whom some of Spicerhaart's printing would be diverted when VLM UK could not cope. Secondly, Spicerhaart was granted a licence to host a copy of the Software on its own servers, that it could rely on when VLM UK's servers were down or where they were otherwise unable to access the hosted software. This was effectively a sub-licence from VLM UK to Spicerhaart to host and use the Software.

However, about a year later, VLM UK went into liquidation and the directors of VLM Holdings resolved in a board meeting that all IP rights granted to VLM UK (whether in writing or not) be terminated with immediate effect. On the assumption that this termination of the informal head-licence between VLM Holdings and VLM UK also automatically terminated the sub-licence between VLM UK and Spicerhaart, VLM Holdings subsequently entered into an exclusive licence and conditional assignment agreement with Ravensworth (the *Agreement*). Under the Agreement, VLM Holdings granted an exclusive licence in respect of the Software to Ravensworth and also agreed to conditionally assign the rights in the Software to Ravensworth. The assignment would be triggered in specific circumstances, including where Ravensworth terminated the Agreement for material breach by VLM Holdings.

Notwithstanding the Agreement, Spicerhaart continued to use its copy of the Software to design its property brochures and diverted the printing to Ravensworth. Ravensworth did not object to Spicerhaart using its copy of the Software until Spicerhaart informed Ravensworth that it would move its printing to a different service provider. This prompted Ravensworth to notify Spicerhaart of its exclusive rights in the Software and ask Spicerhaart to stop using and deliver up the Software. Spicerhaart refused to do so pointing to its sub-licence which, according to Spicerhaart, was still on foot.

Ravensworth then failed to make a royalty payment to VLM Holdings which prompted VLM Holdings to seek to terminate the Agreement. Eventually, VLM Holdings sued Ravensworth for breach of the licence. Ravensworth counterclaimed arguing that the continued licence to Spicerhaart breached its exclusive licence.

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entitling Ravensworth to stop paying royalties and to terminate the Agreement for material breach which in turn would trigger the conditional assignment.

Key issue

The key issue for the Court to decide was whether Spicerhaart's sub-licence had survived the termination of the head-licence following the liquidation of VLM UK:

- if it had survived, VLM Holdings had breached the Agreement and the question would be if that breach was material so that it would trigger the assignment; and
- if it had not survived, VLM Holdings had not breached the Agreement and Ravensworth's failure to pay royalties entitled VLM Holdings to terminate the Agreement and Ravensworth had no rights in the Software.

The Court's reasoning

The Court was quick to reject VLM Holdings' submission that the sub-licence had automatically fallen away when the informal head-licence was terminated by way of the board resolution. This submission was based on the *nemo dat quod non habet* maxim which means 'you cannot give what you do not have'. According to the single judge, this maxim was 'best left alone'³.

Mann J started from a different proposition, namely that a licence is a permission to do something that would otherwise be unlawful and it does not create a proprietary right. According to Mann J, the task at hand was to determine the exact scope of that permission by looking at the circumstances surrounding the grant of the head-licence and the sub-licence. Mann J stated that there may well be circumstances in which a sub-licence survives the termination of the head-licence, including for example, where express terms permit sub-licences which are capable of surviving the termination of the head-licence.

According to Mann J, the answer to the question of whether a sub-licence survives the termination of the related head-licence lies in the notion of authority:

'The real question is therefore as to the scope of the authority given by the head licensor to the sub-licensor. That depends on all the facts. If the authority is sufficiently wide to allow the grant of a sub-licence which is capable of surviving the termination of the head licence, then the head licensor (copyright owner) must be taken as giving the ultimate permission himself, on normal agency principles.'⁴

In order to answer the question as to what authority the sub-licensor (VLM UK) had been given by the copyright owner (VLM Holdings) in relation to the Software, Mann J considered some further facts, including the following:

- VLM Holdings and VLM UK had common directors and these precise individuals were involved in the grant of the sub-licence;

- both VLM Holdings and VLM UK wished to have the sub-licence in place and benefited from it;
- VLM UK was the trading company and VLM Holdings allowed it to do what was necessary to exploit the IP rights the subject of the informal licence;
- the sub-licence agreement incorrectly referred to VLM UK as the copyright owner and nothing else was done to inform Spicerhaart that VLM Holdings was the actual copyright owner (in other words, Spicerhaart was unaware that it was granted a sub-licence only);
- the sub-licence was for a 6-year term and could thereafter be terminated by Spicerhaart only and not by VLM UK (except for breach and insolvency); and
- the sub-licence was critical to Spicerhaart's business and its purpose was to protect Spicerhaart from VLM UK's inability to deliver (including as a consequence of ceasing to trade). Mann J found that this business purpose would have been frustrated if the termination of the informal head-licence was capable of bringing the sub-licence to an end.⁵

On the basis of these material facts and on the application of agency principles, Mann J drew the conclusion that the sub-licence to Spicerhaart had survived the termination of the head-licence. Mann J stated that VLM Holdings and VLM UK should both be taken to have knowledge of, and to have approved, the licence to Spicerhaart and that 'it would be wholly artificial to distinguish between them'⁶ for the purpose of the licence. He found that the directors of VLM Holdings had impliedly consented to the granting of the sub-licence and, at least, impliedly authorised VLM UK to grant it. Consequently, the licence as a permission to do that which would otherwise be unlawful came from both VLM UK and VLM Holdings. As Spicerhaart was unaware that VLM UK was not the copyright owner, VLM Holdings was to be treated as undisclosed principal and therefore under ordinary agency principles, the licence as a permission to use the Software came from both VLM Holdings and VLM UK. However, Mann J clarified that this did not mean that Spicerhaart could treat VLM Holdings as the other contracting party (as is normally the case under the undisclosed principle doctrine). Rather, the authority given by VLM Holdings was not to bind it in the whole contract but an authority to enter into the sub-licence, and therefore, the permission granted by the sub-licence should be treated as a permission given by VLM Holdings and VLM UK.⁷ Mann J went on to find that:

'Bringing to an end the informal licensing arrangements between [VLM] Holdings and [VLM] UK would not be capable of affecting the permission already given by [VLM] Holdings under the

Spicerhaart licence, so the licence persisted. [VLM] UK's licence for the future was revoked but that did not affect this particular prior act.⁸

In case his analysis was wrong, Mann J offered estoppel as an alternative approach to come to the conclusion that the sub-licence was still on foot. He found that VLM Holdings was estopped from asserting its ownership free from the sub-licence as it allowed VLM UK to refer to itself as the copyright owner in the sub-licence document and to behave as though it was the copyright owner.

So what?

The decision is far from laying down a general principle that sub-licences survive the termination or expiry of the related head-licence. The case was decided on very specific facts. In the absence of a close connection between the rights owner and sub-licensor as in the present case and in the absence of facts which support the application of the undisclosed principal doctrine, it would usually be difficult to infer a direct permission from the rights owner to the sub-licensor.

However, where rights owners allow for sub-licences to be granted without expressly providing that sub-licences terminate when the related head-licence terminates or expires, they would be ill-advised to assume the same. It seems that as long as there is an intact flow-down of rights from the rights owner via the sub-licensor to the sub-licensee at the time of the granting of the sub-licence, that flow-down of rights will not necessarily be disrupted by a subsequent termination or expiry of the licence from the rights owner to the sub-licensor. Rather, where the authority granted by the rights owner to the sub-licensor in respect of the licensed rights is broad (often the case in informal intra-company licensing arrangements where the rights owner might adopt a laissez-faire approach) there seems to be a considerable risk (from a rights owner's point of view) that sub-licences granted under that arrangement can survive without the head-licence still in place.

That said, there is no guarantee for sub-licensees that their sub-licensed rights survive the termination or expiry of the related head-licence.

Drafting licences and sub-licences

In the absence of further cases on point⁹, it is difficult to predict in what circumstances a court would come to the conclusion that a sub-licence survived the termination or expiry of the head-licence where the licence agreement is silent on this point. It is in the interests of all parties to clearly agree the scope and limitations of any sub-licences (including the impact of the termination/ expiry of the head-licence on the sub-licence) and to expressly document those in the formal licence agreements. Unless specific circumstances warrant otherwise, the standard position (and certainly the preferred position for a rights owner) would generally be to provide in the head-licence for automatic termination of the sub-licence should the head-licence fall away, and to require any sub-licences to reflect the same.

While sub-licensees might want a sub-licence to survive independently of the fate of the head-licence or might want an assurance that a rights owner will step into the shoes of the sub-licensor should the head-licence come to an end, in practice, these approaches are likely to be resisted by rights owners. In that case, expressly stating in the licence agreements that a sub-licence falls away when the related head-licence does, may even serve a sub-licensee better than silence on this point. Firstly, such limited rights would usually come at a cheaper price. Secondly, the sub-licensee could tailor its business accordingly (ie., perhaps put in place a back-up plan for when the sub-licence terminates) and request adequate notice before a termination takes effect. And thirdly, this approach would minimise the risk of costly and lengthy court proceedings which can have a detrimental effect on a business regardless of their final outcome.

Other jurisdictions

Finally, it should be noted that in two decisions¹⁰ handed down in July last year, the highest German Court¹¹ found that respective copyright sub-licences¹² had survived the termination of the related head-licences. Unlike the UK decision, the German decisions are seen as laying down a general principle that sub-licences do survive the termination of the head-licence unless expressly provided otherwise. While the German decisions will not be persuasive to an Australian court, they might become relevant to Australian businesses in international licensing scenarios and they further illustrate the impact that sub-licences can have on a rights owner's ability to freely deal with its rights.

Conclusion

When negotiating and drafting licence agreements, sub-licences might seem no more than a distant possibility down the track. However, not giving them adequate attention at that point in time can cause complex issues in the future and cost all involved dearly.

¹ [2013] EWHC 228 (Ch).

² The decision has not been appealed and the time for filing an appeal has expired.

³ *VLM Holdings Ltd v Ravensworth Digital Services Ltd* [2013] EWHC 228 [60]

⁴ *Ibid* [61].

⁵ *Ibid* [64].

⁶ *Ibid* [63].

⁷ *Ibid* [65].

⁸ *Ibid* [66].

⁹ The only other relevant case quoted by Mann J is *A Baldwin & Co Ltd v Magnetic Car Co Ltd* (1925) 42 RPC 454. On the analysis provided by Mann J that case did not lay down any particular principles. Rather, the conclusion in that case, that the relevant sub-licence had not survived the termination of the relevant head-licence, was based on the finding that the terms of the head-licence entitled the head-licensor to terminate the head-licence as well as any sub-licences under it and the sub-licensee was to be taken to have known this.

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¹⁰ M2Trade (I ZR 70/10) and Take Five (I ZR 24/11).

¹¹ The 'Bundesgerichtshof'.

¹² In one case (Take Five) the surviving sub-licence was an exclusive licence for the duration of the copyright.