

Understanding sub-licenses in intellectual property

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25 Jun 2013

Unpacking the intricacies of sub-licenses of intellectual property (IP), where the initial or main license is revoked or cancelled.

It is common for a company that owns IP, such as trademarks, patents and copyright, to grant another company the right to use that IP.

The grant of the right to use IP is referred to as a 'licence'; the company that grants the right is referred to as the 'licensor' and the company that gets the right is referred to as the 'licensee'.

Often, the licence will provide that the licensee is itself entitled to grant licences to use the IP. These further licences are referred to as 'sub-licenses' and the further licensees as 'sub-licensees'. One sees this quite often in franchise arrangements or in situations where the owner of IP is trying to establish itself in a foreign country.

However, what happens to a sub-licence if the initial, main licence is cancelled depends on the circumstances.

Finding in favour of sub-license continuation

There was a recent UK court decision that dealt with this issue, the case of VLM Holdings Limited v Ravensworth Digital Services Ltd. The facts were straightforward. A company called VLM granted what is described in the report as an 'informal licence' to use the copyright in certain software to its subsidiary company, VLM (UK), which, in turn, granted a sub-licence to a firm of estate agents called Spicerhaart.

When VLM (UK) went into liquidation, VLM terminated its licence with the main licensee, VLM (UK) and went on to grant an exclusive licence to the software to another company called Ravensworth. When Ravensworth found out that Spicerhaart was using the same software under licence, it sued VLM for breach of contract. Therefore, the issue that arose was this: had the sub-licence that VLM (UK) granted to Spicerhaart survived the termination of the main licence it had received from VLM.

Yes said the court, in a decision that may have surprised and even alarmed some people. The court started off by making the general point that a licence is nothing more than a permission to do something that is otherwise unlawful, and that it does not create any proprietary right.

It follows therefore, said the court, that if the main licence not only allows the licensee to grant sub-licenses but also

suggests that the sub-licences can survive termination of the initial licence, then that is in fact what should happen, because that is what the licensor wanted and in fact permitted.

The court felt that the somewhat unusual facts of this case suggested that it was the licensor's intention that sub-licences should survive termination of the initial licence. One such fact was that VLM and VLM (UK) had directors in common, and these directors had clearly approved of the decision of VLM (UK) to sub-licence Spicerhaart.

The court found that the Spicerhaart deal would benefit both companies (and particularly VLM which was the trading company and which needed to exploit the copyright) and that both VLM and VLM (UK) had benefited from a related agreement in terms of which Spicerhaart referred work to them.

A second consideration was the fact the terms of the sub-licence were very favourable for Spicerhaart - for example, the licence ran for a period of six years with a follow-up period that could be terminated only by Spicerhaart and not VLM (UK) and the agreement also protected Spicerhaart from any disruption to its use of the software.

The court felt that this was intended to protect Spicerhaart's right to use the software in various contingencies, including the very one that had arisen, namely the insolvency of VLM (UK) followed by a termination of the main licence.

A third consideration was the fact that VLM had allowed VLM (UK) to describe itself in the sub-licence as the owner of the copyright - the court felt that under agency principles a licence had been granted to Spicerhaart by both VLM and VLM (UK).

Creating initial clauses to avoid this issue

These are an unusual set of facts and certainly no guarantee that a court will always find that the sub-licence survives the termination of the initial licence. Moreover, there is a very simple way of ensuring that it does not - the initial licence should have a clause saying that all sub-licences terminate on termination of the initial licence and it should also require the licensee to stipulate in the sub-licence that the sub-licence terminates, if the initial licence ends.

An informal licence should be avoided at all costs. In addition, it is worth remembering that the law imposes certain requirements when it comes to licences.

The South African Copyright Act, for example, provides that, although a non-exclusive licence can be oral, an exclusive licence is not valid unless it is in writing.

The Trade Marks Act, on the other hand, provides that any authorised (permitted) use of a trademark is deemed to be use by the owner, which can be very important if one ever needs to prove that one's trademark registration has been used and is therefore still valid. The act goes on to provide that a permitted user can be formally recorded as a registered user - one of the benefits of recordal is that the registered user can in certain circumstances sue for trademark infringement.

Licensing plays an extremely important role in the exploitation of IP. It should therefore be taken very seriously.

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- Ilse du Plessis is Director at Edward Nathan Sonnenbergs (ENS) IP department
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