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KNOWLEDGE NUGGETS

RISKS FOR THE LICENSEE IN THE EVENT OF THE LICENSOR'S INSOLVENCY

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I. WHY THIS TOPIC IS IMPORTANT

IP licenses—whether for trademarks, patents, or copyrights—are typically business-critical for licensee companies. Product lines, IT infrastructure, and brand identities often depend directly on the continued right to use these intellectual property (IP) rights. The economic consequences of losing such licenses can be substantial and may pose an existential threat to the licensee's investments in its product portfolio, IT integration, and brand equity. Accordingly, a forward-looking approach is essential at the time of entering into license agreements.

In the event of the licensor's insolvency, the so-called "right of election" of the insolvency administrator applies: this right of election allows the insolvency administrator, in the case of reciprocal contracts that have not yet been fully performed (e.g., a license in exchange for regular license fees), to choose between performance and non-performance. If the administrator chooses non-performance, the continued use of the IP right becomes—to put it simply—prohibited. The licensee is left with only a claim for damages, which they can file as a simple insolvency claim in the insolvency schedule, whereas the insolvency quota is often low. Contract clauses that exclude this right of election are also generally invalid.

By contrast, license purchases that have already been fully performed (permanent and irrevocable rights of use granted in exchange for a one-time fee) are generally beyond the administrator's control.

II. PRACTICAL SOLUTIONS

Advisory practice addresses this unsatisfactory situation for the licensee with various protective measures, which, however, also do not offer unlimited protection:

- **Sublicenses:** According to established case law of the Federal Court of Justice (*BGH*), a validly granted sublicense generally remains in effect even if the main license is terminated (succession protection). According to prevailing opinion, this is likely to apply to simple (non-exclusive) licenses as well, provided that sublicensing is contractually permitted and the sublicense was validly granted—however, explicit confirmation by a higher court is still pending.
- **Trust/Escrow Arrangements:** The relevant IP right (e.g., a trademark or source code for software) is transferred to an independent trustee, who transfers the right of use to the licensee in the event of the licensor's insolvency. Limitations arise from the potential circumvention of the insolvency administrator's right of election, as well as from risks associated with insolvency challenges.
- **License-Securing Usufruct:** The licensee is granted a usufruct (right in rem to use) in the relevant IP. This approach is likely to work only with exclusive licenses, is often difficult to

negotiate, and is also controversial due to the potential circumvention of the insolvency administrator's right of election.

- **Lien/Assignment for Security:** The IP right is pledged to the licensee or assigned to the licensee as security. In the event of insolvency, however, this merely results in a right of separation, i.e., satisfaction from the proceeds of liquidation, which will hardly compensate for the damage resulting from the loss of the license.
- **Transfer Subject to a Condition Precedent:** The IP right is transferred to the licensee subject to a condition precedent. If properly worded, this may be immune to insolvency challenges; however, a "purchase price" is generally due upon fulfillment of the condition.

With the exception of sublicensing, the approaches mentioned are likely to be applicable in practice only to exclusive licenses. Furthermore, it must be taken into account that none of these approaches can ensure the continuous further development or maintenance of the IP right beyond the insolvency proceedings.

III. RECOMMENDATIONS

- **Pre-contractual review and operational precautions:** Examine structuring options (purchase of a license vs. perpetual license), consider replacement licenses and alternative trademark concepts, and prepare technology fallbacks ("Plan B").
- **Clear documentation:** Clearly define sublicensing rights, license fees, ancillary obligations (e.g., maintenance, defense), termination clauses, and escrow triggers.
- **Strategically utilize sublicenses:** Where economically feasible, utilize sublicense tiers and structure sublicenses independently; maintain flexibility in cash flows. If applicable, consider assigning sublicense fees to the master licensor.
- **Escrow and other safeguards:** To the extent feasible, establish source code, trademark, patent, or legal escrow arrangements with objective release events (e.g., opening order, declaration of non-performance).
- **Security interests with prudence:** Use usufruct, pledge, and security assignment only with clear documentation and taking insolvency challenge risks into consideration.
- **Insolvency-specific governance:** Contact the insolvency administrator promptly and monitor statutory deadlines for the administrator's right of election; where appropriate, establish registry monitoring (e.g., for insolvency entries under Section 29 of the German Trademark Act (*MarkenG*)).
- **Involve counsel in a timely manner:** Strategy should be closely coordinated with IP and insolvency lawyers as early as the negotiation of license agreements, and at the latest when dealing with the insolvency administrator in the event of insolvency.

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