IP Licenses and Insolvency Guide - United Kingdom

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# 1. What does the applicable law provide regarding the treatment of IP license agreements in insolvency proceedings in your jurisdiction?

## 1 (a). What are the general principles of the treatment of IP license agreements in insolvency proceedings? Is there a difference depending on the type of proceeding (e.g., a court-appointed receivership, a bankruptcy, a restructuring, etc.)?

The insolvency of a UK incorporated licensor will not usually affect the validity of an IP license and would not result in an automatic termination of an IP license.

The overall position of IP licenses needs to be assessed in light of the Corporate Insolvency and Governance Act (the "CIG Act") which was introduced as a bill into the UK Parliament on 20 May 2020, and came into force on 26 June 2020. The CIG Act effected significant changes to UK insolvency law in a number of areas, including in relation to *ipso facto* clauses (termination by reason of insolvency).

Section 14 of the CIG Act introduced a new section into the Insolvency Act 1986 which restricts the operation of such clauses in contracts for the supply of goods or services where a company enters into an "insolvency procedure" (*e.g.*, the implementation of a CVA or a company going into administration or liquidation). The CIG Act does not include a definition of a "contract for the supply of goods or services" but the meaning is potentially broad. While each agreement would need to be assessed on a case-by-case basis, as a matter of ordinary language, a contract to supply services would be capable of including a contract under which one party agrees to allow another party to take use of IP rights. There also seems to be a good argument that it was within the intended policy of the legislation to preclude the operation of ipso facto clauses in relation to such agreements, since the continued ability to use IP rights may be essential to the ability to restructure a company.

On the assumption therefore that an IP license would be in scope of such provisions, there would be a prohibition on the termination of an IP license or 'doing any other thing' (*e.g.*, amending payment terms) in respect of that contract, simply by reason of the company entering into an 'insolvency procedure' (even where the IP license gives a termination right in those circumstances). Other grounds of termination (*i.e.*, that are not based on insolvency, such as non-payment) may still be utilized, if triggered following the entry of the Licensee into an insolvency procedure and it should be noted that the legislation incorporates "late triggers" meaning a Licensor is largely restricted from taking action at the point at which its Licensee is subject to a formal insolvency procedure of one sort or another but not prevented from terminating (if the IP License allows it) at earlier signs of financial distress or insolvency.

There are some limited circumstances in which a UK insolvency office holder appointed to manage a liquidation can "disclaim" the terms of a license (where the property is an unprofitable contract or is unsaleable). Equally, if an insolvency professional disregarded the terms of the license in breach of its terms, the remedy in damages for the licensee may, in practical terms, be worthless as that claim would rank as an unsecured claim in the licensor's estate, in respect of which any recoveries would be low/minimal.

## 1 (b). What are the laws governing the treatment of IP license agreements in insolvency proceedings?

In the UK, there is no express statutory provision that deals specifically with the impact of insolvency on IP licenses, and IP licenses are treated in the same way as other contracts of an insolvent UK entity.

In the absence of any contractual provisions in the IP license dealing with insolvency, the UK insolvency of the licensor or the appointment of an insolvency office holder would not result in the automatic termination of an IP license granted by the UK licensor to a licensee. Generally, the key objective of any UK insolvency office holder is to either realize the assets of the licensor for the maximum amount possible or achieve the survival of the licensor. If preservation of the license is not considered to be in the best interests of the insolvent estate, the insolvency office holder could:

terminate the license (if there is a contractual right allowing them to do so);

cause the insolvent entity to repudiate or decline to perform, *i.e.*, breach the license (giving rise to an unsecured and potentially valueless claim to the licensee for damages for breach of contract); or

if the company has appointed a liquidator, "disclaim" the license (the risk of the license being disclaimed is limited only to a company that has entered into **liquidation**); disclaimer is not available in an administration. A liquidator only has the power to disclaim "onerous property." Onerous property is (i) any unprofitable contract and (ii) any other property of the company that is unsalable, not readily saleable, or is such that it may give rise to a liability to pay money or perform any other onerous act.

The disclaimer of onerous property only operates to determine the rights, interests and liabilities of the company (*i.e.*, the licensor) in the license, and it serves to release the company from its liabilities. However, it does not affect the rights or liabilities of another person or counterparty to a contract (*i.e.*, the licensee). This means that if the licensor's liquidator disclaims the license, the licensee nevertheless retains the right to use any licensed IP, as the disclaimer only operates to release the insolvent company from its obligations and does not affect the rights of the licensee. Furthermore, where a liquidator disclaims an IP license, an entity with an "interest" in the IP in question (*e.g.*, an exclusive licensee) can appeal to the court to have the property vested in it as per s 181 of the Insolvency Act 1986.

However, despite the fact that it should be possible as a matter of law for an IP license to survive the insolvency of a UK licensor, there is very limited actual authority of this being tested in UK courts.

# 2. Are contractual provisions automatically terminating licenses (and distribution agreements) or automatically transferring licensed IPR to the licensee by virtue of an act of insolvency valid and enforceable, having regard to anti-deprivation rules?

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Where the licensee is in administration, the administration moratorium prevents the exercise of security or proprietary rights over assets.

Under the CIG Act a new freestanding moratorium has been introduced which could also be used to give a licensee short-term breathing space. While the new moratorium is similar in scope to that which applies in administration, the administration moratorium is more powerful as there are a number of notable exceptions to the "payment holiday" provided under the standalone moratorium, including the requirement that financial debt must continue to be met. Under the new moratorium, the directors remain in control of the company, albeit overseen by an insolvency practitioner acting as the "monitor".

See discussion in Question 1 above in relation to the ability of a Licensor to rely on contractual rights of termination.

If the license contains express contractual provisions that automatically assign the licensed IPR to the licensee upon insolvency, then it is likely valid and enforceable. A provision of this kind would need to be considered carefully, and any purchase price would need to be set at an arm's length amount to avoid falling foul of the anti-‍deprivation principle. This provision would also need to contain an irrevocable power of attorney in favor of the licensee so that it can take all of the steps necessary to perfect the assignment back.

# 3. What does this practically mean for licensors and licensees?

## 3 (a). Does a license agreement remain valid during an insolvency proceeding

Yes, a license agreement would remain valid during an insolvency proceeding, subject to contrary contractual provisions (as discussed above). The Insolvency Act 1986 does not provide for the automatic termination of IP licenses on insolvency. See above commentary for when an insolvency professional might disregard or "disclaim" a license.

## 3 (b). Is the trustee or receiver obliged to perform the obligations under a license agreement?

In practical terms, no. If the insolvency professional caused or allowed the insolvent entity to repudiate or decline to perform, *i.e.*, breach the license, this would likely give rise to an unsecured and potentially valueless claim to the licensee for damages for breach of contract.

## 3 (c). What can a licensee do, if anything, to protect its right to use the licensed IPR?

**Record the license**

For IP that is registered in the UK, a licensee can record their interest as licensee with the IP Office. A license that is registered in this way will be binding on any successor in title to the UK registered IP right. If the license is not registered at the IP Office, a license granted by the owner of a UK registered IP right will still bind any successor in title to the UK registered IP, except a purchaser of those rights who buys them for good value, in good faith and without notice of the license. This means that, if an insolvency office holder was to try to sell on the registered IP to another party as part of either a going concern sale of the business and assets or a break up sale, as long as (i) the license had not been disclaimed or terminated and (ii) either the new owner has actual notice of the license or the license is recorded on the public register, then the new owner of the UK registered IP right would be bound by the terms of the license. The position in relation to rights registered in other countries but which are licensed by an insolvent UK licensor would depend on the local rules around registration of licenses.

**Contractual considerations**

Include clauses in the license which stipulate that any transfer of the rights by the licensor is subject to the license;

Seek to limit any contractual rights of the licensor to terminate the license, including on insolvency of either party;

Include in the license a pre-emption right or an option for the licensee to buy the IP, exercisable on certain pre-insolvency events such as failure to pay renewal fees for the IP; or

Include clauses in the license such that if the licensor becomes insolvent, the license will become perpetual and royalty-free. This is suitable in instances where the license is of rights created specifically for a particular business (*e.g.*, customized software).

**Structural/pricing considerations**

The licensee could seek a parent company or directors' personal guarantee of the licensor's obligations under the license.

Take the benefit of security over the IP. The registration of the security interest on the relevant IP register or at Companies House may have the effect of putting a new licensee or buyer on notice of the existing license, and dissuade them from engaging with the office holder in breach of the disclosed license.

The license could be structured so that a bullet payment is made at the end of the license period. In practical terms, this may persuade an insolvency office holder to hold off terminating the license until the office holder is able to receive the payment for the benefit of the creditors.

Using an escrow arrangement, the licensor would assign the licensed IP to an escrow agent, for the escrow agent to hold on trust. The escrow agent, via an escrow agreement between the escrow agent, licensee and licensor, would hold the IP on trust for the licensee and the licensor on the basis that, on the insolvency of the licensor, the escrow agent would transfer the IP to the licensee. Escrows are not commonly used other than in the context of software, where parties do sometimes put the source code into escrow for release on insolvency. Even in instances where parties set up an escrow arrangement, they rarely have the discipline to use it effectively as it requires regular updates to the source code being held.

## 3 (d). Can a licensor prevent a trustee or receiver from selling or transferring the insolvent licensee's rights under a license agreement?

This would be determined by the terms of the contract and its governing law. There is no over-arching principle that would override those terms.

# 4. Are there differences regarding trademark, copyright and patent licenses, noting any exceptions, e.g., mandatory licensing or standard essential patents?

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No.

For the purposes of insolvency in the UK, there are no differences between the treatment each of the main IP rights ("**IPR**").  However, it should be noted that the differing inherent elements of each right may make it easier, or alternatively more challenging, to protect as licensed IPR (per our comments above) depending on the nature of the underlying IPR.

For example, patents, trade marks and registered designs are all registered rights against which licenses of those rights can be recorded centrally, which makes it easier to give notice on the licensee’s right.  However these rights are also subject to the payment of renewal fees in order to remain validly enforceable.

On the other hand copyright is not a registrable right in the UK, and therefore a licensee will not have the option to centrally record its licensed IPR, but instead might take the benefit of holding security over the IPR in order to register their interest. If the relevant copyright interest is held for example in respect of software, then it might also be more likely that an escrow arrangement can be put in place to protect the licensee’s copyright interest in the source code.

Each of the IP rights will be treated the same for the purposes of insolvency, but there will often be differing strategic considerations in relation to the preferred method of protection.

# 5. Is there a risk in transferring licensed IPR to a third party in anticipation of an insolvency?

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There is a risk in that this transaction would be considered as a transaction defrauding creditors under s 423 IA 1986. This is because it has broad application and does not require the company to be insolvent.

A transaction defrauding creditors is established if (i) the IPR is transferred at an undervalue to the third party and (ii) the purpose of this transaction is to put assets beyond the reach of a person who is making or may make a claim against the company, or to otherwise prejudice a person's interest in relation to such a claim. Further, if the licensor went into an insolvency process, the office holder can challenge and review transactions that lead up to the insolvency. There is also a risk (on similar grounds as the s 423 offense above) that a transaction entered into during the two years before the onset of insolvency could potentially be challenged as a transaction at an undervalue under s 238 IA 1986.

# Contacts

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