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German Copyright Law Sets Limitations on Exclusive Licenses

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The German parliament adopted a series of amendments to copyright law designed to protect authors of copyright works ("authors") against the perceived superior bargaining power of the copyright industry. The new rules introduced into German copyright law late last year focus on "full buy-out" contracts where rights are granted to the publisher exclusively in consideration of a one-off lump sum payment (with no running royalties being payable). The new law tackles situations where authors give away the whole value of their work before its true commercial potential is tested in the market and will also help authors and creators in case of under-exploitation or under-investment by the publisher.

The following new rules will apply to licensing contracts for German copyright works concluded as from **1 March 2017**:

1. **Exclusivity reduced to 10 years (§ 40a UrhG – German Copyright Act)**: Where exclusive license rights are granted against the payment of a **lump sum** (a flat licence fee) with no obligation to pay ongoing royalties, by law after an initial **10-year-**period the license will be deemed non-exclusive and the author will be free to exploit the licensed work and to grant licenses to other parties. The new rule will significantly strengthen authors' rights, particularly in "full buy-out" scenarios.
   After an initial **5-year** period (which would allow the author time to learn how the work is being exploited by the exclusive licensee) the parties will be free to re-negotiate the contract and to agree to extend the exclusivity beyond the 10-year limitation. This will allow authors an opportunity to demand additional compensation as a price for the extended exclusivity, particularly where the work proves to be successful by the end of the first 5 years.
2. **Reporting obligations (§§ 32 d, 32e UrhG – German Copyright Act)**: The new rules provide authors the statutory right to require licensees to provide **annual** reports setting out details of the manner in which the licensed works are being used and the proceeds generated by the licensees from such exploitation. Likewise, authors will be able to require such reports to be furnished by sub-licensees to allow the author to assess the exploitation of the works concerned). Perhaps surprisingly to non-German readers, the authors' right to obtain reports from licensees will not be limited to royalty-bearing licenses but also will apply in "full buy-out" contracts (that is, a license in consideration of the payment of a one-off lump sum). It is envisaged that authors

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would use such information in the context of negotiations for the extension of exclusivity after the initial 5 years (as referred to in 1 above) and above all to assess whether they may have a statutory claim for additional reasonable compensation: The latter is a right already available under a mandatory law introduced in 2002 which gives authors an opportunity to claim top-up license fees where in the light of licensee's actual use of the licensed work and the level of proceeds generated from the work, the amount of consideration originally agreed in the license agreement is strikingly unreasonable.

3. **Exemption for collective arrangements**: The German legislature encourages and strengthens the use of collective exploitation arrangements concluded between authors' associations and licensees/users/user trade associations and the use of trade union agreements (together "Collective arrangements"), which are perceived to provide authors with a better bargaining power and a fairer deal for authors. Accordingly, the new rules provide that Collective arrangements may derogate from the restrictions imposed by the law on exclusive licenses. In the terms of the new law, a license contract **may only derogate** from the new limitation on the period of exclusivity and the newly adopted reporting obligations if it is in line with such Collective arrangement. The law also provides for authors' associations to have the right to pursue non-compliance with Collective arrangements by way of applications to the courts for injunctions.

4. **Software and other sectors exempted**: The software industry will be pleased to note that **software** will be exempted from the new rules. Exemptions also largely apply to **film** rights. Furthermore, the 10 year exclusivity time limit may be derogated from in contracts relating to works of **architecture**, works to be used as **trademarks** or **designs**, or works **not intended for publication**. Arguably, this exception is likely to capture most commissions for engineering or scientific works as well as works relating to commercial processes in the context of the development and production of commercial products and services.

Comments: It remains to be seen whether the new law will achieve its declared aim of ensuring more fairness in the copyright industry, particularly in the media services and arts sectors (in a broad sense). The copyright industry may react to the new rules by revising compensation policies and market prices may shift to reflect additional costs for reporting requirements and reduced exclusivity benefits. Generally speaking, the legislature expects self-regulation to achieve a fair and flexible balance through the improved framework for Collective arrangements, which may derogate from the new rules, but this might be putting too much trust into a system that some perceive as being inflexible and not suitable in many circumstances. In principle the new rules also apply to employment relationships. Those may, however, in many circumstances benefit from the exemptions outlined above, assuming proper drafting.

As always, a number of details will have to be clarified by the courts. For example, it is unclear how courts will react to creative structures, such as splitting the consideration for a license into a predominant lump sum element and a less significant recurring royalty payment. Such structures might well be perceived as circumvention attempts and the courts may still impose the limitation on the period of exclusivity. It is further unclear how the rules imposing a shortened exclusivity period will affect sub-licensing arrangements. Arguably, those should also in principle become automatically non-exclusive at the expiry of the 10 year period as the author will have the statutory right to exploit the work. Could

an exclusive sub-licensee claim damages from the head-licensee? Would the sub-licensee have a claim to reduce license fee rates once the exclusivity no longer applies? How will the courts apply recent case law granting sub-licenses some independence from the main license in situations where the main license becomes subject to statutory limitations? As so often, much will depend on circumstances of each individual case and proper contract drafting.

International contracts: While clearly mandatory as to German law contracts, the new law fails to clarify expressly whether and to what extent the new rules apply as overriding mandatory provisions to license contracts governed by foreign (non-German) law. Where there is a genuine foreign element, this question remains unsettled and there are valid arguments both ways.

- A 2014 high court case on copyright law (BGH *Hi Hotel II*) emphasized that a statutory provision's mandatory nature (as an overriding mandatory provision within the meaning of Art. 9 of the Rome I Regulation) cannot be assumed lightly, particularly where the copyright law's express provisions on the mandatory application of certain statutory provisions to foreign law contracts, does not refer to the statutory provision in question. The logic of that case would speak in favour of allowing foreign law contracts to derogate from the new rules.
- However, general concepts of reasonable interpretation, territoriality and conflict of laws may still lead the courts to a different result. The new reporting obligations (§§ 32d/e UrhG) are closely associated with the authors' rights to fair compensation (§§ 32, 32a UrhG), which the law expressly treats as mandatory provisions that apply to foreign law as well as German law contracts (§ 32b UrhG). That close association would support treating the reporting obligations as an overriding mandatory provision, because they are intended to facilitate the effective pursuit of the mandatory claim for fair compensation.
- It is even more difficult to anticipate how the courts would treat the limitations on the period of exclusivity (§ 40a UrhG) which is less directly related to the mandatory provisions laying down the claim for fair compensation. Nevertheless, a strictly mandatory nature could be assumed from other factors: (i) the limitation on the period of exclusivity can be seen to determine the scope of copyright protection and operate as a statutory "reversionary interest" of the author; and (ii) the new law expressly permits derogations from its provisions only by Collective arrangements, which may suggest that in all other respects the statutory limitation is of the nature of an overriding mandatory provision.

In the end courts will have to decide those issues. Until then, a prudent, author-friendly approach would assume the strictly mandatory nature of the new rules at least to the extent use rights in Germany are concerned. In practice, even if the new rules were not deemed strictly mandatory in an international context, licensees may run into strong negotiation positions by local authors along the lines of the new law.

What to do: Existing contracts are not affected, but new contracts (and possibly amendments to existing contracts) that are concluded from 1 March 2017 will be subject to the new law. Assuming the application of German law, the economics of copyright contracts in non-exempted sectors will have to take account of the maximum 10 year exclusivity period for one-off payment "buy-out-" contracts and the additional costs arising from the annual reporting obligations (which would otherwise normally apply only

in royalty contracts). To the extent not already done, licensees would need to put in place procedures to document the exploitation of licensed rights in order to be able to comply with the reporting obligations. Contracts with sub-licensees should reflect the shortened exclusivity period and should impose corresponding reporting obligations on sub-licensees (backed-up by suitable indemnification clauses). Where appropriate or necessary to avoid problems arising from the shortened exclusivity period, licensees should consider royalty based models as opposed to lump sum payments. Where applicable, contract drafting should reflect the factors that would support an exemption.