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## Commercial Advisor

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### **Ninth Circuit Finds Security Interests in Unregistered Copyrights Governed by California Uniform Commercial Code, Not Copyright Act**

A recent decision by the U.S. Ninth Circuit Court of Appeals found that security interests in *unregistered copyrights* are to be perfected by the filing of Uniform Commercial Code (UCC) financing statements in accordance with applicable state law, and that federal law does not require that any registration be filed in the U.S. Copyright Office. In [\*In re World Auxiliary Power Co.\*](#), 303F.3d 1120 (9th Cir.), the Ninth Circuit affirmed a district court decision that security interests which had been granted by the borrower to Silicon Valley Bank in unregistered copyrights were perfected by making traditional UCC filings. This decision limited the application of the Ninth Circuit's prior decision in *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194, 204 (C.D. Cal. 1990), and undercut other decisions, including *In re AEG Acquisition Corp.*, 161 B.R. 50 (B.A.P. 9th Cir. 1993) and *In re Avalon Software Inc.*, 209 B.R. 517 (D. Ariz. 1997).

Perhaps more important for borrowers and lenders is the question that the Ninth Circuit considered, but did not resolve—does a perfected security interest in unregistered copyrights become unperfected if the lender takes no further action and the borrower subsequently registers the copyright? In its decision, the Ninth Circuit suggests that the risk of subsequent registration should fall onto the lender's shoulders—leaving lenders to make sure that borrowers disclose copyright registrations by implementing appropriate loan covenants and policing mechanisms.

Although this decision suggests that previous demands by lenders to register all “copyrightable” material will be lessened, in practice, it may result in further diligence by lenders and more stringent notification obligations.

### **Facts of the Case**

In *In re World Auxiliary Power*, three affiliated corporations designed and sold products for modifying airplanes. The three companies owned copyrights in the drawings, technical manuals, blueprints and computer software used to make the modifications. Silicon Valley Bank provided financing to two of the companies, and the third guaranteed the loan. To secure their obligations, the companies granted the bank a security interest in “all copyrights, copyright applications, copyrights registrations, and like protections in each work of authorship and derivative work thereof, whether published or unpublished, now owned or hereafter acquired.” The bank perfected its security interest pursuant to the California Uniform Commercial Code (UCC) by filing financing statements with the California secretary of state. The bank did not file any document showing the transfer of a security interest with the Copyright Office.

Subsequently, the three debtor companies filed simultaneous but separate bankruptcy proceedings. Through an approved bankruptcy sale and various other intermediate transfers, two unrelated companies, Aerocon Engineering and Airweld, acquired, as tenants in common, the debtors' copyrights and the bankruptcy trustees' right to sue to avoid Silicon Valley Bank's security interest.

Meanwhile, Silicon Valley Bank won relief from the bankruptcy court's automatic stay and, based on its security interest, foreclosed on the copyrights. Silicon Valley Bank then sold the copyrights to Advanced Aerospace, which then sold the copyrights to Airweld. Aerocon then brought an adversary proceeding in the debtors' bankruptcy proceedings against Silicon Valley Bank, Advanced Aerospace, Airweld and certain other transferees to avoid Silicon Valley Bank's security interest and recover the copyrights or their value.

### **The Ninth Circuit's Opinion**

To decide this appeal, the Ninth Circuit reviewed the U.S. Copyright Act and the California

UCC. The court first noted that the Copyright Act does not provide a recordation and priority scheme to govern the perfection and priority of security interests in *unregistered copyrights*, and further stated that "[t]here just isn't any way for a secured creditor to preserve a priority in an unregistered copyright by recording anything in the Copyright Office." The court stated that in the absence of coverage of unregistered copyrights by the Copyright Act, the "only reasonable inference to draw is that Congress chose not to create a federal scheme for security interests in unregistered copyrights, but left the matter to States, which have traditionally governed security interests."

The court also noted that under the California UCC, unregistered copyrights would be treated for security interest purposes as "general intangibles." The California UCC also provides two "step back provisions," by which the state law defers to conflicting federal law. See Cal. Comm. Code §§ 9104(a) and 9302. The court found that under these two step-back provisions, "there can be no questions that, when a copyright has been registered, a security interest can be perfected only by recording the transfer in the Copyright Office," and specifically adopted the holding in *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194, 204 (C.D. Cal. 1990), to that limited extent.

However, since the Copyright Act "doesn't provide for the rights of secured parties to unregistered copyrights; it only covers the rights of secured parties in *registered* copyrights," the court found that the California UCC did not step back to the Copyright Act with respect to unregistered copyrights. The court rejected *In re AEG Acquisition Corp.* and *In re Avalon Software Inc.*, to the extent such lower court decisions had extended *Peregrine* to unregistered copyrights. The court did not reject the *Avalon* court's finding that unless a lender has a perfected security interest in the underlying registered copyright, the lender does not have a security interest in any account receivables (such as licensing fees) arising out of the sale or licensing of such registered copyrights.

In doing so, the court noted that extending *Peregrine* to unregistered copyrights would make registration of copyrights a prerequisite of perfecting a security interest. This would make unregistered copyrights practically useless as collateral, an "inference the text and purpose of

the Copyright Act do not warrant."

Accordingly, the court found that Aerocon could not avoid the security interests of Silicon Valley Bank that had been properly perfected under the California UCC by the filing of a financing statement.

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