

## Client Advisory

February 2002

# Ninth Circuit Holds Exclusive Copyright Licenses Not Transferable

In a decision that could have a significant impact on businesses that license copyrighted material, the United States Court of Appeals for the Ninth Circuit has ruled that the owner of an exclusive copyright license may not transfer its interest unless it has or obtains the original licensor's consent. The Ninth Circuit's ruling on this issue of "first impression" requires those involved in numerous industries – including entertainment, new media, software, merchandising, advertising and publishing – to rethink the manner in which they grant or obtain exclusive rights to copyrighted content and to review the manner in which they have done so in the past.

The Ninth Circuit reached its conclusion in *Gardner v. Nike, Inc.*, 2002 WL 123296 (9<sup>th</sup> Cir. January 31, 2002). The dispute centered around Nike's grant to Sony Music Entertainment Corporation of an exclusive, perpetual, worldwide license to exploit a cartoon character, which had been developed by Nike, in musical recordings, television programs, motion pictures, merchandise and clothing, among other things. Their agreement was silent as to Sony's right to assign its rights to another party.

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Sony subsequently assigned all of its rights in the Nike character to Gardner in exchange for a share of the proceeds derived by Gardner from the exploitation of the character. Nike objected, and litigation commenced over the validity of Sony's transfer. The federal district court granted summary judgment in Nike's favor, ruling that the transfer was invalid under the Copyright Act.

## No Transfers Permitted

The Ninth Circuit affirmed. The appellate court noted that under the current Copyright Act – which applies to transfers made since January 1, 1978 – "copyright ownership" includes an assignment, an exclusive license, or any other conveyance "of any of the exclusive rights comprised in a copyright." It also acknowledged that under section 201(d) of the Copyright Act, these exclusive rights of copyright (such as the right to perform, reproduce, distribute and make derivative works of a copyrighted work) may be transferred and owned separately.

But the court declined to conclude that an exclusive licensee has the same rights as the original copyright owner to transfer its rights to a third party. To the contrary, the court ruled that section 201(d)(2) of the Copyright Act makes a clear distinction between the original copyright owner and the owner of an exclu-

sive right of copyright: The copyright owner has the right to transfer its entire copyright interest or any of the exclusive rights comprising a copyright; the owner of an exclusive right, by contrast, is only “entitled, to the extent of that right, to all of the *protection and remedies* accorded to the copyright owner.”

According to the Ninth Circuit, the “protections and remedies” provided by the Copyright Act do not include the right of transfer. Therefore, “an exclusive licensee has the burden of obtaining the licensor’s consent before it may assign its rights, absent explicit contractual language to the contrary.”

## Decision Criticized

This interpretation of the Copyright Act has been criticized by at least one of the leading authorities on copyright law. Addressing the lower court’s ruling in *Gardner, Nimmer on Copyright* expresses the view that “sound policy reasons combine with

copyright’s constitutional moorings to construe exclusive licenses as transferable.” One federal bankruptcy court in New York specifically rejected the holding as well, concluding that “the licensee under an exclusive license may freely

transfer his rights.” *In re Patient Education Media, Inc.*, 210 B. R. 237, 240 (S.D.N.Y. 1997). Another bankruptcy court in Delaware, relying on *In re Patient Education Media*, stated in *dicta* that “an exclusive licensee does acquire property rights and ‘may freely transfer his rights.’” *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 311, 314 (D. Del. 2001).

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But the Ninth Circuit may not be alone in its view. In *Morris v. Business Concepts, Inc.*, 259 F.3d 65 (2d Cir. 2001), the Second Circuit was also required to interpret section 201(d)(2) of the Copyright Act, albeit in a completely different factual context. Like the Ninth Circuit, the Second Circuit concluded that section 201(d)(2) “draws a distinction between a copyright owner and an exclusive licensee,” that the language of this section “mandates the conclusion that an exclusive licensee is not a copyright owner” and that exclusive licensees are only treated as copyright owners for the purpose of the “protection and remedies” afforded by the Copyright Act. Extrapolating from this ruling, in the appropriate case the Second Circuit might well reach the conclusion that an exclusive licensee does not have the right to transfer its rights absent consent by the copyright owner.

## Practical Implications

Where does the Ninth Circuit’s ruling leave companies that convey or acquire exclusive copyright licenses as an essential component of their businesses? The answer may well depend upon *how* a particular company conducts business. Many entertainment companies, which both acquire and convey exclusive rights of copyright, utilize comprehensive license agreements that expressly address the licensee’s right to sublicense or assign its rights to others. Some of the established new media businesses also fully document the rights and obligations of the parties to an exclusive software license.

But this is not always the case. Sometimes, the exclusive right to produce a motion picture based on a copyrighted novel or to distribute an existing television series is memorialized in a “short form” agreement that does not specifically address the licensee’s right to transfer all or a portion of its rights. Those in the software, advertising and merchandising industries frequently incorporate cursory license provisions into their more formal agreements that do not include the specific right to sublicense or assign.

To be sure, that an exclusive licensee may sublicense or assign certain rights to others is often the implicit expectation of the contracting parties, and the licensee's inability to do so may undermine the very purpose of the agreement. Nonetheless, the Ninth Circuit's ruling appears to require the licensee to obtain the licensor's *express* consent to transfer. Under these circumstances, the licensee's ability to sublicense its rights to others may well be in jeopardy.

The Ninth Circuit's decision also has implications for other common transfers of exclusive rights in copyright, whether by contract or operation of law, such as copyright mortgages. The producer of a theatrical motion picture, for example, is frequently required to pledge its copyright in the underlying work as security for repayment of a production loan. The developer of a Web site typically licenses its "source code" to the site's operator, who will often use that license as collateral for start-up or other financing. If the borrower fails to repay the loan, the lender has the right to foreclose on the collateral and to take ownership of the borrower's copyright interest. But if the agreement by which the borrower acquired its exclusive rights did not include an express right of transfer, the security interest might be considered unenforceable and an eventual foreclosure sale might be voidable.

A wide range of corporate transactions, from mergers and acquisitions to simple restructuring, may also involve the transfer of an exclusive right of copyright that would not be permissible under the Ninth Circuit's ruling in *Gardner*. And it is not clear whether federal copyright law or federal bankruptcy law would prevail in a confrontation arising from the potential sale of a debtor's interest in an exclusive copyright license that does not expressly permit a transfer.

## Further Proceedings

Although the appellants in *Gardner* may seek rehearing by the entire Ninth Circuit, the appellate court will only grant such *en banc* review when it is necessary to secure or maintain uniformity of that court's decisions or when presented with "a question of exceptional importance." The appellants may also petition for review by the Supreme Court, but the odds are great that this petition would be denied as well. Supreme Court review is a matter of judicial discretion, which will only be granted under compelling circumstances, such as when the decisions of different appellate courts conflict on the same important issue. At present, there is no such conflict.

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For the time being, it should be assumed that the owner of one or more of the exclusive rights of copyright does not have the same right to freely transfer its copyright interest as the copyright holder enjoys. Exclusive licenses negotiated in the future should expressly address the licensee's right to assign or sublicense its rights. And parties to existing licenses that do not explicitly grant such consent to the licensee should evaluate carefully what, if anything, they can do now to clarify and protect their rights.

## We Can Help

Katten Muchin Zavis Rosenman's attorneys in entertainment, media and intellectual property can assist you in responding to this new copyright ruling. If you have any questions about this Advisory or other related issues, you may contact the following attorneys:

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