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Focus

Copyright Licensee Must Have Owner's Approval to Sublicense

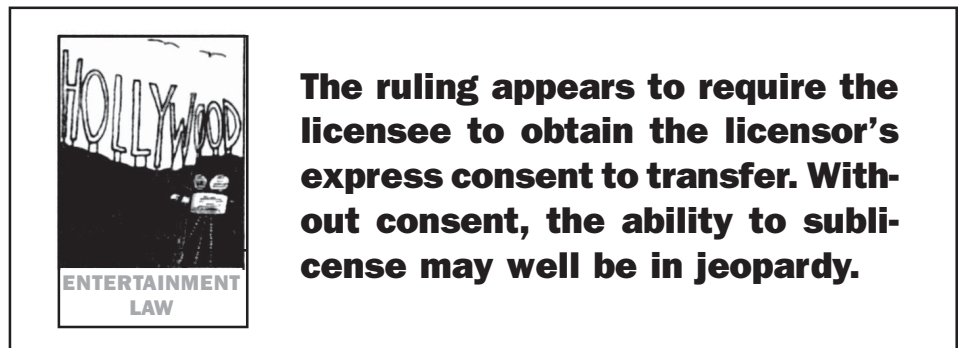
By David Halberstadter
and Katherine McDaniel

In a decision that could have a significant impact on businesses that license copyrighted material, the 9th U.S. Circuit Court of Appeals 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 9th 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 review the manner in which they have done so in the past.

The 9th Circuit reached its conclusion in *Gardner v. Nike Inc.*, 279 F.3d 774 (9th Cir. 2002). The dispute centered around Nike's grant to a music label 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 the licensee's right to assign its rights to another party.

The music label subsequently assigned all of its rights in the Nike character to Michael Gardner and his company 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 the transfer. The federal District Court granted summary judgment in Nike's favor, ruling that the transfer was invalid under the Copyright Act.



The ruling appears to require the licensee to obtain the licensor's express consent to transfer. Without consent, the ability to sublicense may well be in jeopardy.

The 9th Circuit affirmed. The court noted that under the current Copyright Act, "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 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. The court ruled that under Section 201(d)(2), the copyright owner has the right to transfer its entire copyright interest or any of the exclusive rights making up a copyright; but the owner of an exclusive right is only "entitled, to the extent of that right, to all of the protection and remedies accorded to the copyright owner."

These "protections and remedies" do not include the right of transfer, according to the 9th Circuit. 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."

At least one of the leading authorities on copyright law has criticized this interpretation of the Copyright Act. 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." 3 Melville B. Nimmer & David Nimmer, "Nimmer on Copyright," Section 10.02 [B][4] (Matthew Bender 2002).

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 Educ. Media Inc.*, 210 B.R. 237 (S.D.N.Y. 1997). Another bankruptcy court in Delaware stated in dicta that "an exclusive licensee does acquire property rights and 'may freely transfer his rights.'" *In re Golden Books Family Entm't Inc.*, 269 B.R. 311 (D. Del. 2001).

But the 9th Circuit may not be alone in its view. In *Morris v. Business Concepts Inc.*, 259 F.3d 65 (2nd Cir. 2001), the 2nd Circuit also was required to

interpret Section 201(d)(2), albeit in a completely different factual context. Like the 9th Circuit, the 2nd Circuit concluded that Section 201(d)(2) “draws a distinction between a copyright owner and an exclusive licensee” and only treats exclusive licensees as copyright owners for the purpose of the “protection and remedies” afforded by the act.

In the appropriate case, the 2nd 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.

Where does the 9th 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 often, 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.

The parties to an exclusive license may well have intended the licensee to have the ability to sublicense or assign certain rights to others. The licensee’s inability to do so may even undermine the very purpose of the agreement. But the 9th Circuit’s ruling appears to require the licensee to obtain the licensor’s express consent to transfer. Without such consent, a licensee’s ability to sublicense its rights to others may well be in jeopardy.

The 9th Circuit’s decision also has implications for other common transfers of exclusive rights in copyright, 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 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 9th 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.

Although the appellants in *Gardner* may seek rehearing by the entire 9th Circuit or petition for Supreme Court review, it is unlikely that either petition will be granted. The appellate court only grants 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 Supreme Court will only grant review 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.

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 does the copyright holder. 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.

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