IN RE WORLD AUXILIARY POWER COMPANY:
A LOOK AT FEDERAL PREEMPTION OF STATE LAW IN THE
PERFECTION OF SECURITY INTERESTS IN REGISTERED
AND UNREGISTERED COPYRIGHTS

I. INTRODUCTION

The perfection of a security interest in a copyright, patent, or trademark is an important resource for businesses relying on intellectual property to obtain financing through secured lending.\(^1\) With the adoption of Article 9 of the Uniform Commercial Code (UCC), courts have struggled to determine the correct manner of creating and perfecting security interests in intellectual property, leaving lenders with uncertainty as to the means of effectively protecting their interests.\(^2\) The confusion in this area has centered on the existence of federal law governing intellectual property and its effect on Article 9 perfection procedures under state law. Separate federal statutes govern the assignment of copyrights, trademarks, and patents; and the question arises as to whether these statutes preempt state laws governing the existence of security interests.\(^3\)

In In re World Auxiliary Power Co.,\(^4\) the United States Court of Appeals for the Ninth Circuit took a step toward clearing up some of the confusion by recognizing a difference in the perfection procedures relating to security interests held in registered and unregistered copyrights.\(^5\) In doing so, the court set out the applicable law concerning federal preemption of state law in the context of Article 9 and concluded that the federal Copy-

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1. Examples of such businesses are software development companies, publishers, and media and internet companies. The most valuable assets held by these types of businesses will often be the intellectual property that they create. For this reason, lenders will seek to secure loans made to these businesses by taking an interest in the intellectual property they own.


3. There are separate federal statutes concerning the assignment or transfer of interests in copyrights, trademarks, and patents, and there is also state law which governs the taking of a security interest in collateral. The problem addressed by this Comment arises where federal law seems to govern an entire area, such as registered copyrights, and the question becomes whether state law governing the area must defer to federal law. See infra Part III.

4. 303 F.3d 1120 (9th Cir. 2002).

5. See id. at 1130.
right Act does not preempt state law governing the perfection of a security interest in an unregistered copyright.6

The purpose of this Comment is to examine the issue of federal preemption of state law in the context of security interests in registered and unregistered copyrights, looking closely at the Ninth Circuit's reasoning in World Auxiliary Power. As the facts of World Auxiliary Power played an important role in the Ninth Circuit's decision, Part II provides an outline of how the case reached the Ninth Circuit.7 Part III then looks at the step-back provisions found in the Uniform Commercial Code.8 Part III.A explains the three circumstances where federal law preempts state law.9 Part III.B analyzes the ruling in In re Peregrine Entertainment.10 which held that copyrights must be perfected under federal law by filing with the Copyright Office,11 and Part III.C explains the Ninth Circuit's decision in World Auxiliary Power, limiting Peregrine Entertainment.12 Finally, Part III.D looks at the problem of a “double-crossing” debtor, examining the burden that the Ninth Circuit has placed on lenders to ensure that debtors have an incentive to notify them of any registration of copyrights in which the lender holds a collateral interest.13

II. IN RE WORLD AUXILIARY POWER COMPANY:
THE ISSUE BEFORE THE NINTH CIRCUIT

A look at the facts of World Auxiliary Power will aid in the understanding of the issue presented to the Ninth Circuit. The case involved a contest in bankruptcy between a bank which held a security interest, perfected under state law, in unregistered copyrights that it obtained from the owners and a company which purchased the copyrights upon bankruptcy from the bankruptcy trustees.14

World Auxiliary Power was one of three affiliated California companies in the business of designing and selling products for modifying airplanes.15 The companies held copyrights in the drawings, blueprints, computer software, and other materials used to make the modifications.16 None of the copyrights held by the company were registered with the United States Copyright Office.17

6. Id. at 1127-32.
7. See infra Part II.
8. See infra Part III.
9. See infra Part III.A.
11. See infra Part III.B.
12. See infra Part III.C.
13. See infra Part III.D.
15. Id. at 1123.
16. Id.
17. Id.
The companies obtained financing from Silicon Valley Bank, and Silicon Valley took a security interest in collateral which included "all copyright rights, copyright applications, copyright registrations, and like protections in each work of authorship and derivative work thereof, whether published or unpublished, now owned or hereafter acquired."\(^{18}\) Silicon Valley Bank, pursuant to California’s version of Uniform Commercial Code Article 9, perfected its security interest in the copyrights and other collateral by filing financing statements with the Secretary of State in California.\(^{19}\) The bank did not place on record with the U.S. Copyright Office any document showing a security interest transfer, and the copyrights remained unregistered with the Copyright Office.\(^{20}\)

The three companies subsequently entered into separate bankruptcies, and the copyrights were some of their major assets.\(^{21}\) A creditor of the companies, Aerocon Engineering, was interested in the copyrights for use in a joint venture with another company, Advanced Aerospace, with the objective of engineering and then selling aircraft modifications designed through the use of the copyrights.\(^{22}\) To solve the problem of Silicon Valley Bank’s holding of a security interest in the copyrights, Aerocon entered into a deal where it purchased the assets of the debtors from the bankruptcy trustees. As a part of the deal, the owners of Advanced Aerospace and another company, Erose Capital, purchased the bankruptcy trustees’ right to sue to avoid the security interest of Silicon Valley Bank.\(^{23}\) The companies planned to use the trustee’s power to avoid Silicon Valley’s interest and receive a clear title to the copyrights.\(^{24}\)

However, things did not work out as planned. The joint venture fell through, and Erose Capital sold its interest in the trustee’s avoidance power to Aerocon, while Advanced Aerospace sold its interest to another company named Airweld.\(^{25}\) After all of these transactions were complete, Airweld and Aerocon held the avoidance power and the copyrights as tenants in common.\(^{26}\)

While all of this occurred, Silicon Valley was able to win relief from the automatic stay put in place by the bankruptcy court.\(^{27}\) They then foreclosed on the copyrights pursuant to the security interest, and subsequently sold the copyrights to Advanced Aerospace, who then sold them to Airweld.\(^{28}\)

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18. Id.
19. Id.
20. Id.
21. Id.
22. Id.
23. Id. at 1123-24.
24. Id. at 1124.
25. Id.
26. Id.
27. Id.
28. Id.
weld now held complete ownership in the copyrights, and Aerocon held an interest adverse to Airweld's.\textsuperscript{29}

Aerocon, utilizing its interest in the trustee's avoidance power, sued to avoid the security interest held by Silicon Valley and to recover the copyrights or their value from Advanced Aerospace and Airweld.\textsuperscript{30} The bankruptcy court granted a motion by Advanced Aerospace and Airweld to dismiss the claim by Aerocon as time-barred, and then granted summary judgment in favor of Silicon Valley on the ground that the security interest in the copyrights was perfected under California's version of Uniform Commercial Code Article 9.\textsuperscript{31} Aerocon's appeal ended up in the district court, which affirmed the bankruptcy court's ruling.\textsuperscript{32} The decision was then appealed to the Ninth Circuit Court of Appeals.\textsuperscript{33}

Silicon Valley took all the steps necessary to perfect its security interest under the law of the State of California.\textsuperscript{34} However, the question that faced the court was whether federal law in the area of copyrights (that is, the Federal Copyright Act) preempted state law. If so, Silicon Valley's security interest in the copyrights would be unperfected, and Aerocon would have a priority interest in the unregistered copyrights.\textsuperscript{35}

III. THE "STEP-BACK" PROVISIONS OF THE UNIFORM COMMERCIAL CODE

To determine whether state law or federal law governed the perfection of Silicon Valley's security interest, the Ninth Circuit looked to California's version of Article 9 of the Uniform Commercial Code.\textsuperscript{36} There are two provisions of Article 9 that require state law to "step-back" when conflicting federal law exists. The first provision provides that "[t]his article does not apply to the extent that . . . a statute, regulation, or treaty of the United States preempts this article."\textsuperscript{37} The Official Comment recognizes a change in this provision from its previous form.\textsuperscript{38} The provision formerly stated that Article 9 does not govern "a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property."\textsuperscript{39} The drafters felt that this language had been erroneously interpreted to suggest that Article 9 may in some cases defer to federal law even when not preempted, so they explicitly set out in the new provision the requirement of

\begin{itemize}
\item \textsuperscript{29} Id.
\item \textsuperscript{30} Id.
\item \textsuperscript{31} Id.
\item \textsuperscript{32} Id.
\item \textsuperscript{33} Id.
\item \textsuperscript{34} Id. at 1125.
\item \textsuperscript{35} Id.
\item \textsuperscript{36} See id. at 1127.
\item \textsuperscript{37} U.C.C. § 9-109(c)(1) (2003).
\item \textsuperscript{38} § 9-109(c)(1) cmt. 8.
\item \textsuperscript{39} Id.
\end{itemize}
preemption. The California Commercial Code, at the time *World Auxiliary Power* was decided, contained the language of the former provision, and this is the language the court cited in its opinion. The differences in the provisions did not affect the court’s analysis, however, because the court found that preemption was not present.

The second, and narrower, step-back provision states:

> [T]he filing of a financing statement is not necessary or effective to perfect a security interest in property subject to . . . a statute, regulation, or treaty of the United States whose requirements for a security interest’s obtaining priority over the rights of a lien creditor with respect to the property preempt Section 9-310(a).

Filing is also not “necessary or effective” for perfection of a security interest when a “non-Uniform Commercial Code central filing statute” exists. And finally, the provision states that “[c]ompliance with the requirements of a statute, regulation, or treaty described in [this provision] for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article.” The official comments explain that the filing provisions of Article 9 do not apply if another filing system, whether federal or state, has been provided for under federal law, and when another system exists, perfection may only occur through compliance with that system. The California Commercial Code provisions applied by the Ninth Circuit contained a slightly different wording, but they provided for the same result, requiring compliance with a filing system provided by federal law.

A. Federal Preemption of State Law

Under the first and broader step-back provision, state law governing the perfection of a security interest will never apply where federal law has preempted state law. The Ninth Circuit, citing a previous decision, recognized three circumstances where federal law preempts state law. First, Congress may explicitly set out that state law is preempted, which is known as “ex-

40. *Id.*
41. *In re World Auxiliary Power Co.*, 303 F.3d 1120, 1127 (9th Cir. 2002).
42. *Id.* at 1128.
44. § 9-311(a)(2).
45. § 9-311(b).
46. § 9-311(a)(2) cmt. 2. For example, a federal statute provides that “[t]he Administrator of the Federal Aviation Administration shall establish a system for recording . . . conveyances that affect an interest in civil aircraft of the United States.” 49 U.S.C.A. § 44107(a)(1) (West 2000). Thus, perfection may occur only through compliance with the system established by the FAA, not through Article 9.
47. *See In re World Auxiliary Power Co.*, 303 F.3d at 1127.
49. *See In re World Auxiliary Power Co.*, 303 F.3d at 1128 (citing Keams v. Tempe Technical Inst., Inc., 39 F.3d 222, 225 (9th Cir. 1994)).
press preemption."

Second, Congress may "occupy the entire field, leaving no room for the operation of state law," leading to the implication that state law in that field has been preempted. This type of preemption is known as "field preemption." Finally, an inference of preemption arises where "compliance with both state and federal law would be impossible, or state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." This final type of preemption is known as "conflict preemption."

B. The Federal Copyright Act and Its Preemptive Effect over State Law Dealing with Security Interests: In re Peregrine

The Copyright Act provides for the ability to record any transfer of ownership or other document pertaining to a copyright in the Copyright Office. A transfer includes a mortgage, which by definition encompasses the granting of a security interest in property. Therefore, the federal Copyright Act allows a transfer of a security interest in a copyright to be recorded in the Copyright Office.

The Copyright Act also sets out a method to determine priority when two conflicting transfers arise. The Copyright Act provides that the first transfer to be executed will prevail if it is recorded in accordance with the constructive notice requirements set out in the statute. Upon looking at this provision of the Copyright Act, an issue arises as to whether it preempts state law governing the perfection of security interests in copyrights. This issue was taken up by the United States District Court for the Central District of California in *Peregrine Entertainment*, and the analysis and hold-

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50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.* at 1128-29.
54. *Id.* at 1128.
55. 17 U.S.C.A. § 205(a) (West 2003). The Federal Copyright Act reads as follows: Any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office if the document filed for recordation bears the actual signature of the person who executed it, or if it is accompanied by a sworn or official certification that it is a true copy of the original, signed document.
56. *Id.* Because the term "may" is used, this right has been held to be permissive rather than mandatory. *See In re Peregrine Entertainment*, 116 B.R. 194, 199 (C.D. Cal. 1990).
57. A mortgage is explicitly included in the definition of a "transfer of copyright ownership" in the Copyright Act. 17 U.S.C.A. § 101 (West 2003).
58. The Copyright Act does not define "mortgage," so the definition must be found in another source. *Black’s Law Dictionary* defines a mortgage as a "conveyance of title to property that is given as security for the payment of a debt or the performance of a duty and that will become void upon payment or performance according to the stipulated terms." *BLACK’S LAW DICTIONARY* 1026 (7th ed. 1999).
59. In *In re Peregrine Entertainment*, National Peregrine, Inc. (NPI) was a Chapter 11 debtor in possession of assets including copyrights and distribution rights to a large number of films. 116 B.R. at 197. A bank, Capital Federal Savings and Loan Association of Denver, gave a large line of credit to American National Enterprises, the predecessor of NPI by merger, taking a security interest in NPI's library of films. *Id.* Financing statements were filed in several states, but the transfer was not recorded in the United States Copyright Office. *Id.* at 198. NPI filed for bankruptcy, and subsequently filed a com-
ning by the court was partially adopted by the Ninth Circuit in *World Auxiliary Power*.

In order for the District Court to find that the Copyright Act preempted state law, the court had to determine that one of the three types of preemption existed: express, field, or conflict. The court began its analysis by looking at the "unique federal interests" implicated by the recording provisions of the Copyright Act. In its holding, the court remarked that "[t]he federal copyright laws ensure predictability and certainty of copyright ownership, promote national uniformity and avoid the practical difficulties of determining and enforcing an author's rights under the differing laws and in the separate courts of the various States." The court went on to state that "[a] recording system works by virtue of the fact that interested parties have a specific place to look in order to discover with certainty whether a particular interest has been transferred or encumbered. To the extent there are competing recordation schemes, this lessens the utility of each."  

The court also looked at the "comprehensive scope" of the Copyright Act as part of its preemption analysis. The court pointed out that "the Copyright Act establishes its own scheme for determining priority between conflicting transferees, one that differs in certain respects from that of Article Nine," and went on to state that "[t]he availability of filing under the UCC would thus undermine the priority scheme established by Congress with respect to copyrights. This type of direct interference with the operation of federal law weighs heavily in favor of preemption."  

With the above analysis, the court appeared to be arguing for both field preemption, where federal law leaves no room for state law, thus leading to an implication of preemption, and conflict preemption, where state law stands in the way of the fulfillment of the objectives and purposes of Congress. Ultimately, the court concluded that "[r]ecording in the U.S. Copy-

plaint alleging that the bank had an unperfected security interest in the films due to the bank's failure to record the security interest with the Copyright Office. *Id.* NPI claimed that it was a debtor in possession, and through this status had a judicial lien on all assets of the debtor's estate which allowed NPI, through its avoidance power, to preserve the bank's unperfected interest in order to benefit the debtor's estate. *Id.* The bankruptcy court held that the bank had correctly perfected its security interest in the film library. *Id.*

60. *In re World Auxiliary Power Co.*, 303 F.3d 1120, 1130 (9th Cir. 2002).
61. *See supra* notes 49-54 and accompanying text.
63. *Id.* at 199 (internal quotations and citation omitted).
64. *Id.* at 200.
65. *Id.* at 199.
66. *Id.* at 201. The Copyright Act provides: "As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice . . . within one month after its execution in the United States or within two months after its execution outside the United States, or any time before recordation in such manner of the later transfer." 11 U.S.C.A. § 205(d) (West 2003). The Uniform Commercial Code provides that, in general, as between holders of conflicting security interests, priority is determined by who is first to file or perfect his interest. U.C.C. § 9-322(a)(1) (2003). Therefore, unlike the UCC, the Copyright Act allows "the effect of recording with the Copyright Office to relate back as far as two months." *In re Peregrine Entertainment*, 116 B.R. at 201.
right Office, rather than filing a financing statement under Article Nine, is the proper method for perfecting a security interest in a copyright." 68

C. The Effect of In re World Auxiliary Power Company on the In re Peregrine Entertainment Rule

The rule set out in Peregrine Entertainment seemed to apply to the perfection of security interests in all copyrights, but did the court intend for both registered and unregistered copyrights to be treated in the same manner? This was the issue faced by the Ninth Circuit in World Auxiliary Power, with the Ninth Circuit holding that registered and unregistered copyrights are to be treated differently. 69

In partially adopting the rule set out in Peregrine Entertainment, the Ninth Circuit never questioned the rule that a security interest in a registered copyright can only be perfected by recording the transfer in the U.S. Copyright Office. 70 It was clear to the court that the provisions of the Copyright Act satisfied both the broad and the narrow UCC step-back provisions. 71 However, because the copyrights at issue in World Auxiliary Power were unregistered, the Ninth Circuit was required to take the preemption analysis further than the court in Peregrine Entertainment. 72

The Copyright Act provides that recording a document in the United States Copyright Office puts all persons on constructive notice of the facts which are stated in the recorded document, but only if two requirements are met. 73 The first requirement is that "the document, or material attached to it, specifically identifies the work to which it pertains so that, after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title or registration number of the work." 74 The second requirement is that "registration has been made for the work." 75

68. Id. at 203.
69. See supra note 5 and accompanying text. With its holding, the Ninth Circuit overruled two lower court opinions which had extended the holding in Peregrine Entertainment to unregistered copyrights. In re World Auxiliary Power Co., 303 F.3d at 1130 (overruling In re AEG Acquisitions Corp., 161 B.R. 50 (9th Cir. B.A.P. 1993); In re Avalon Software Inc., 209 B.R. 517 (D. Ariz. 1997)).
70. In re World Auxiliary Power Co., 303 F.3d at 1128.
71. Id. The Ninth Circuit found that the provisions of the Copyright Act which set out a priority scheme for conflicting transfers sufficiently "governs the rights of parties to and third parties affected by transactions" to bring the broad step-back provision into effect and allow federal law to govern in the area of registered copyrights. Id. (quoting CAL. COMM. CODE § 9104(a)); see supra notes 37-41. The court also found the narrow step-back provision to be fulfilled because the Copyright Act created a "national registration" for security interests in registered copyrights. In re World Auxiliary Power Co., 303 F.3d at 1128; see supra notes 42-45.
72. In re World Auxiliary Power Co., 303 F.3d at 1130. The Ninth Circuit points out that the In re Peregrine Entertainment decision never specified whether the copyrights at issue were registered. Id. at 1129. However, the Ninth Circuit assumed that because the collateral involved was a movie library subject to licensing by exhibitors, which in the ordinary course would be registered, the copyrights were probably registered and therefore the In re Peregrine Entertainment court did not consider a case involving unregistered copyrights. Id.
73. 17 U.S.C.A. § 205(c) (West 2003).
74. § 205(c)(1).
75. § 205(c)(2).
The two requirements for recordation clearly mandate that a copyright be registered in order to give constructive notice of the facts stated in the document.\textsuperscript{76} With the priority scheme set out by the Copyright Act only awarding priority to a transfer if the recordation gives constructive notice, priority under this scheme can only be achieved by registration of the copyright.\textsuperscript{77}

The requirement of registration was the determining factor in the Ninth Circuit’s holding that the UCC was not preempted by the Copyright Act in the perfection of security interests in unregistered copyrights.\textsuperscript{78} First, because the priority scheme set out by the Copyright Act does not provide for the rights of secured parties with respect to unregistered copyrights, the broader step-back provision of the UCC cannot apply.\textsuperscript{79} Also, because no place of central filing is set out by the Copyright Act for unregistered copyrights, the narrower step-back provision of the UCC is also inapplicable.\textsuperscript{80}

By requiring that security interests in unregistered copyrights be perfected by filing in the Copyright Office, the Ninth Circuit would have been mandating registration in every instance where a security interest is taken in a copyright.\textsuperscript{81} The court, for several reasons, refused to take this step. First, by requiring registration as a condition of perfection, the court would have made unregistered copyrights essentially useless as collateral for loans.\textsuperscript{82} The Ninth Circuit stated that Congress could not have intended this result.

\textsuperscript{76} See supra note 58 and accompanying text.

\textsuperscript{77} § 205(c). The Ninth Circuit makes this clear by stating:

A copyrighted work only gets a “title or registration number” that would be revealed by a search if it’s registered. Since an unregistered work doesn’t have a title or registration number that would be “revealed by a reasonable search,” recording a security interest in an unregistered copyright in the Copyright Office wouldn’t give “constructive notice” under the Copyright Act, and, because it wouldn’t, it couldn’t preserve a creditor’s priority. There just isn’t any way for a secured party to preserve a priority in an unregistered copyright by recording anything in the Copyright Office. And the secured party can’t get around this problem by registering the copyright, because the secured party isn’t the owner of the copyright, and the Copyright Act states that only the “owner of the copyright . . . may obtain registration of the copyright claim . . . .”

\textit{In re World Auxiliary Power Co.}, 303 F.3d at 1126.

\textsuperscript{78} The court continually points to a statement made by the bankruptcy judge in his decision reached prior to the appeal where the judge stated that “Peregrine’s analysis only works if the copyright was registered.” \textit{In re World Auxiliary Power Co.}, 303 F.3d at 1129-30 (internal quotations and citation omitted).

\textsuperscript{79} The broader step-back provision of the UCC provides that “[t]his article does not apply to the extent that . . . a statute, regulation, or treaty of the United States preempts this article.” U.C.C. § 9-109(c)(1) (2003). The Ninth Circuit reasoned that because the Copyright Act provides no scheme dealing with the rights of secured parties when unregistered copyrights are concerned, the Copyright Act does not preempt the UCC, and therefore the U.C.C. does not defer to the Copyright Act in this area of law. \textit{In re World Auxiliary Power Co.}, 303 F.3d at 1128.

\textsuperscript{80} The narrower step-back provision of the UCC provides that filing is not “necessary or effective” for perfection of a security interest when a “non-Uniform Commercial Code central filing statute” exists. U.C.C. § 9-311(a)(1) (2003). Because copyrights are not required to be registered, and “unregistered copyrights don’t have a registered name and number,” \textit{In re World Auxiliary Power Co.}, 303 F.3d at 1128, there can be no legal ramifications associated with recording an unregistered copyright with the Copyright Office. The legal effect of perfecting a security interest is governed only by the UCC, and the UCC does not defer to the Copyright Act in this area. \textit{Id.}

\textsuperscript{81} \textit{In re World Auxiliary Power Co.}, 303 F.3d at 1130.

\textsuperscript{82} \textit{Id.}
and that "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."\(^{83}\) Second, the Ninth Circuit believed that Congress contemplated that copyrights would usually not be registered, and would never have intended registration as a requirement for recommendation.\(^{84}\) The most telling evidence of Congressional intent is the use of the word "may" in the registration statute, making it clear the Congress meant registration to be permissive rather than mandatory.\(^{85}\)

D. The "Double-Crossing Debtor"\(^{86}\)

The Ninth Circuit, with its holding in *World Auxiliary Power*, clearly intended to preserve the value of unregistered copyrights as collateral.\(^{87}\) But did it accomplish its objective? To answer this question, we must consider a situation where a debtor obtains financing using an unregistered copyright as collateral, then registers the copyrights and obtains secondary financing using the same copyrights as collateral, with the second lender filing under federal law and taking a priority interest in the collateral due to the Copyright Act governing priority upon registration.\(^{88}\)

Aerocon argued to the Ninth Circuit that, in the above situation, by allowing perfection under state law, the "basic objective of federal copyright law" is frustrated.\(^{89}\) Aerocon's contention was that the chance of a debtor registering a copyright and triggering federal law after it had obtained financing using the unregistered copyright as collateral would lead lenders to assign little or no value to an unregistered copyright.\(^{90}\) The Ninth Circuit dismissed this argument, stating that "[p]rudent creditors will always demand that debtors disclose any copyright registrations and perfect under federal law and will protect themselves against subsequent creditors gaining

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83. *Id.* at 1131. The court also explained its position by stating that there is no reason to infer from Congress's silence as to unregistered copyrights an intent to make such copyrights useless as collateral by preempting state law but not providing any federal priority scheme for unregistered copyrights. That would amount to a presumption in favor of federal preemption, but we are required to presume just the opposite. *Id.*

84. *Id.*

85. *Id.* (citing 17 U.S.C.A. § 408(a) (West 2003)).

86. *Id.* at 1131.

87. *Id.* at 1132.

88. Aerocon made this argument to the Ninth Circuit, which the Ninth Circuit summarized as Aerocon "conjuring] up the image of a double-crossing debtor who, having gotten financing based on unregistered copyrights, registers them, thus triggering federal law, and gets financing from a second creditor, who then records its interest with the Copyright Office and takes priority." *Id.* at 1131.

89. The basic objective of federal copyright law is "to promote the Progress of Science and useful Arts by establishing a marketable right to the use of one's expression and supplying the economic incentive to create and disseminate ideas." *Id.* (citing U.S. CONST. art. 1, § 8; Harper & Row, Publishers v. Nation Enters., 471 U.S. 539, 558 (1985)).

90. *Id.* at 1131.
priority by means of covenants and policing mechanisms." 91 The court went on to state that "[a]s we read the law, unregistered copyrights have value as collateral, discounted by the remote potential for priming." 92

By taking this position, the Ninth Circuit placed the burden on lenders to establish a system whereby they will be notified of any copyright registration by one of their borrowers. 93 Upon notification, the lender would be able to perfect under federal law by filing with the Copyright Office. The lender would have to build other protection mechanisms into its agreement with the borrower to protect against a borrower who leaves the lender uninformed of registration. The court also relied on the opinion of several amici banks and associations which indicated they would lend "subject to the remote risk of being 'primed' by subsequent creditors." 94

While the Ninth Circuit seemed to shape its opinion to say that the debtor will not be harmed by placing the burden on lenders to ensure they are protected against the "double-crossing" debtor, the debtor will still likely face some harm in the aftermath of the court's decision. Since the risk of a subsequent lender taking priority in collateral is present due to federal law preempting state law when a copyright is registered, the lender will likely find a way to shift this risk to the debtor, whether it is through a higher interest rate or by other means.

The Ninth Circuit also stated in its opinion that "since a fee is charged and time and effort is required, the [Copyright Act] sets up a regime in which most copyrights won't ever be registered." 95 For the court's reasoning in World Auxiliary Power to be coherent, one must assume that the amount by which the collateral value of the unregistered copyright is discounted would be less than the cost, including actual cost along with time and effort, of registering the copyright. Otherwise, the borrower using copyrights as collateral would be better off by registering the copyright in order to avoid the discount in the collateral value. If the borrower holds unregistered copyrights and, due to the discounted value, they are not sufficient collateral for the loan, the lender will either require more collateral or will charge a higher interest rate. In either situation, it may be advantageous for the borrower to register the copyrights. Therefore, while the Ninth Circuit may have, in theory, preserved some value in the use of unregistered copyrights as collateral, the court's decision has driven lenders to implement protection mechanisms that guard against priming by other lenders, and by doing this may have decreased the value of unregistered copyrights as col-

91. Id. at 1132.
92. Id. By "priming," the court refers to the potential for subsequent creditors to take a priority interest in the collateral by filing under federal law. See id.
94. In re World Auxiliary Power Co., 303 F.3d 1120, 1132 (9th Cir. 2002).
95. Id. at 1131.
lateral and caused borrowers to register their copyrights, leading to the federal preemption that the Ninth Circuit tried to avoid.

IV. CONCLUSION

With the existence of federal law governing intellectual property, an issue arises concerning its effect on Article 9 perfection procedures under state law. The Ninth Circuit's decision in *World Auxiliary Power* set out a clear rule that federal law does not preempt state law in the perfection of a security interest in unregistered copyrights. The court's intent in reaching such a conclusion was to preserve the collateral value of unregistered copyrights. However, the court failed to consider the fact that the lenders, due to the risk of a "double-crossing debtor," will look to place this risk on the borrower, and that due to this shifting of risk it may be advantageous for the borrower to register his copyright. If this occurs, the Ninth Circuit did not reach its goal, as the value of the unregistered copyrights has been impaired enough to cause the borrower to register the copyright. With this consideration in mind, another circuit may reach a different conclusion than that reached by the Ninth Circuit in *World Auxiliary Power*.

Marcus A. Huff

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96. *Supra* note 79.
97. *In re World Auxiliary Power Co.*, 303 F.3d at 1132.
98. *Supra* note 86.
99. *See supra* Part III.D.