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Film Financings and Problems In Copyright Perfection

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Financiers—perhaps as much as producers, directors, and actors—are responsible for the film industry. Without lenders and investors, films cannot be made. Typically, financiers provide funding in return for proceeds from the film, which is secured by a lien in favor of the financier. The lien typically functions as collateral against the borrower's repayment of the loan and compliance with other obligations under the financing agreement. If the borrower fails to meet its loan repayment obligations, the financier is entitled to foreclose on the collateral. Unlike lending and investing in more traditional industries where there is a multiplicity of existing assets, liens in film financings frequently center on the underlying work's copyright, as copyright is the crux of the film's value and frequently the only asset of importance to secure against. And given that financing is necessary at the



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incipiency of a film project, typically a copyright application on an as-yet unfinished script is all that exists. Unfortunately, the law on how to perfect a lien in a copyright application is foggy at best. Below, we sketch out pitfalls of the current process for perfecting a lien on a copyright application, and potential steps that a financier may take to help perfect and protect its investment.

Setting the Scene: The Importance of Perfection

In order for a lien in a film's copyright to be fully enforceable in the United States, it must be perfected. Perfecting the lien establishes priority between conflicting conveyances involving the same copyrighted work

by providing constructive notice to the public of the facts stated in the lien documents. See Copyright Act of 1976 §205, 17 U.S.C. §205(c). Once the lien is perfected, the lender or investor obtains priority over other parties who have an interest in the film's copyright, and is protected from losing its interest in the event of conflicting assignments or the copyright owner's bankruptcy. See U.C.C. §9-322(a)(2). Conversely, if a lender or investor fails to properly perfect its security interest in the copyright collateral, the lender or investor is relegated to the status of an unsecured creditor, and accordingly may be unable to foreclose on the collateral and recoup its losses.

The method for perfecting a secu-

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ity interest in a copyright for which there is no registration or application is well-settled. Article 9 of the Uniform Commercial Code (U.C.C.) governs transactions that create a security interest in “general intangibles,” which include copyright. See U.C.C. §§9-109(a)(1), 9-102(42); U.C.C. §9-102 cmt. 5(d). Under the U.C.C., perfection of a security interest generally requires filing of a U.C.C.-1 statement with the Secretary of State of the state where the creditor/borrower is located. See U.C.C. §§9-307; 9-301 cmt. 4. In *In re World Auxiliary Power*, the Ninth Circuit held that a bank’s security interest in unregistered copyrights was properly perfected pursuant to Article 9 of the U.C.C., on grounds that “[o]nly the U.C.C. creates a filing system applicable to unregistered copyrights.” 303 F.3d 1120, 1130 (9th Cir. 2001); see also *Morgan Creek Prods. v. Franchise Pictures (In re Franchise Pictures)*, 389 B.R. 131, 141 (Bankr. C.D. Cal. 2008).

Article 9 does not apply, however, “to the extent that a statute, regulation, or treaty of the United States preempts [it].” U.C.C. §9-109(c)(1). One such statute that preempts Article 9 regarding perfection of a security interest in federally registered copyrights is the Copyright Act. See *Peregrine Producers Grp., Inc. v. Capitol Fed. Sav. & Loan Ass’n of Denver (In re Peregrine Entm’t Ltd.)*, 116 B.R. 194, 205 (Bankr. C.D. Cal. 1990). In *In re Peregrine Entertainment Ltd.*, a creditor secured its line of credit by taking a lien in a film library, which included the copyrights in the films. The creditor filed U.C.C. financing

statements in a number of states, but did not record the security interest with the Copyright Office even though the films were covered by copyright registrations. The debtor later filed a petition for bankruptcy and disputed whether the creditor had an enforceable lien in the copyrights. The court held that the creditor had not validly perfected its copyright security, and that a secu-

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urity interest in a registered copyright can only be perfected by recording the security interest with the Copyright Office. “Here, the comprehensive scope of the federal Copyright Act’s recording provisions, along with the unique federal interests they implicate, support the view that federal law preempts state methods of perfecting security interests in copyrights. If state methods of perfection were valid, a third party (such as a potential purchaser of the copyright) who wanted to learn of any encumbrances thereon would have to check not merely the indices of the U.S. Copyright Office, but also the indices of any relevant secretary of state [The possibility that] interested third parties could never be entirely sure that all relevant jurisdictions have been searched, . . . together with the expense and

delay of conducting searches in a variety of jurisdictions, could hinder the purchase and sale of copyrights, frustrating Congress’s policy that copyrights be readily transferable in commerce.” *Id.* at 199-200.

The Plot Thickens

Although perfection of a security in an unregistered copyright or a copyright registration is clear, how to perfect a security interest in a copyright application is—at best—murky. Yet this is the position that many film financing parties find themselves in, given that financing typically occurs early in the development of a film project, when a copyright application has recently been filed or will be filed but has not registered (it can take up to a year or two for a registration certificate to be issued by the Copyright Office).

In this connection, constructive notice will not attach and priority will not vest until the security document is indexed against the copyrighted work’s registration number or title. A copyright application is not given an application number after filing with the Copyright Office, and a film’s working title frequently differs from its ultimate title. Further complicating matters, the effective date of a copyright registration is the date that the Copyright Office receives the application materials, but searchable Copyright Office records are often months behind the most recent copyright filing date, which means that a search of the Copyright Office records may not reveal an earlier security interest

that has been filed against a copyright application. Accordingly, recording of a security interest in the copyright application may not provide constructive notice in relation to the copyright registration that ultimately issues. Conversely, once the copyright registration issues, the prior filing of a U.C.C. statement would no longer be effective given preemption.

Final Scene: Thoughts And Recommendations

Given the uncertain interplay between federal and state law regarding perfection of copyright interest in copyright applications, practitioners should consider pursuing both the federal and state means for perfection as a best course of action. Specifically, where there is not yet a copyright registration, a financing party (or its counsel) should consider (1) filing a U.C.C.-1 financing statement against the unregistered copyright in the film, and (2) recording a security interest with the United States Copyright Office in the copyright application (if filed) or recording a security interest with the United States Copyright Office in the title of the film (if a copyright application has not been filed).

But for film financings, this is not the end of the story. The financing party should be aware that once the unregistered work becomes registered, the Copyright Act automatically applies, and accordingly the security interest may need to be re-recorded with the U.S. Copyright Office to perfect. Under the

current—and imperfect—state of the law, this three-step approach to recording may be the only sure way to perfect a lien in a film copyright.

In addition, there are certain pre-emptive steps that film financiers can take when drafting security agreements to improve their position. For example, they can

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ensure that the collateral description includes everything associated with the copyright, from the screenplay to film reels. Financiers should also include an “after-acquired” clause in the security agreement to include within the lien all subsequent copyright rights in the script and film, given that these frequently are developed further over time. Also, the financier could require the filmmaker to promptly file to register the copyright in the screenplay (if not yet filed) and to file to register any newly acquired or created copyright, and to notify the secured lender or investor of any such newly acquired or created copyright material (and the issuance of any copyright registrations thereon) to permit the financier to properly perfect its interest in the collateral. Finally,

if a copyright application has not yet been filed, the financier can file its security interest in the Copyright Office against the film title, and require the filmmaker to only file for copyright under the same title—in this way, the earlier filed copyright security interest can match up with and apply to the later-filed film copyright application.

Finally, to decrease the time lag between applying for copyright registration and receiving the certificate of registration, financiers also should consider requiring the filmmaker to request “Special Handling” when filing the copyright application to expedite the issuance of a registration certificate (to as short as five working days), for an increased fee. See *Special Handling*, U.S. Copyright Office.

These steps should be repeated and updated with respect to new developments in the film, as various aspects of a film—from plot, to characters, to soundtrack, to post-production work—evolve throughout production. When it comes to lending or investing in a film, a financier’s biggest concern should be whether the film will be a blockbuster—and not whether its security in the film copyright is secure.