APPENDIX 15 - PEREGRINE: THE COMPLETE PREEMPTION CASE

A. The Peregrine Holding

The narrow issue in *Peregrine* involved "perfection" of copyright collateral and related receivables. In an earlier Bankruptcy Court decision, the secured party, Capital Federal, sought to enforce a security agreement covering film copyrights.[1] Capital had filed U.C.C. Article Nine financing statements covering the collateral described in its security agreement in several states. However, Capital did not record the security agreement or a memorandum thereof as a "transfer of copyright ownership" in the Federal Copyright Office. The debtor-in-possession (armed with the rights of a bankruptcy trustee) moved the Bankruptcy Court to treat Capital's security interest as "unperfected" in the absence of a Copyright Office recording. If Capital's interest was not perfected under Article Nine, it would be vulnerable to a lien creditor under section 9-301(1)(b).[2] Because the debtor-in-possession had the rights of a hypothetical lien creditor under section 544(a)(1) of the Bankruptcy Code, Capital's security interest could be avoided.[3] The controversy was framed in the Bankruptcy Court, as a filing issue under the partial step-back rule in section 9-302(3).[4] The issue turned on whether the state filings perfected the security interest for purposes of the state law priority rule in Article Nine section 9-301(1)(b) or whether the Copyright Act recording requirements displaced the otherwise appropriate state filing under U.C.C. section 9-302(3)&(4).

In light of the partial step-back language in Article Nine section 9-302(3)(a) and (4), the Bank's security interest seems to have been unperfected as a matter of state law. As explained in Section II(f)(3), Official Comment 8 to section 9-302 clearly identifies the recording provisions of the Copyright Act as "a statute . . . of the United States which provides for a national . . . registration" within the meaning of the deferral rule in section 9-302(3)(a). Subsection (4) of section 9-302 further provides that compliance with such a displacing "statute of the United States"

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1 116 B.R. at 198.

2 Under section 9-301(1)(b), an unperfected security interest "is subordinate to the rights of ... a person who becomes a lien creditor before the security interest is perfected." U.C.C. § 9-301(1)(b).

3 11 U.S.C. § 544(a)(1) (1988).

4 *In re* National Peregrine, Inc., No. 89-01991-LF, 1989 Bankr. LEXIS 2469 at *9 (Bankr. C.D. Calif. 1989).

becomes the exclusive method of perfection. Nevertheless, the Bankruptcy Court ignored section 9-302(4) and concluded that, while Capital could have "perfected" by recording in the Copyright Office, its U.C.C. filing was sufficient to give it priority against the hypothetical lien creditor.[5] The Bankruptcy Court decision seemed clearly mistaken regarding the effect of a displacing national registry under the partial step-back in section 9-302(3)(a) and (4), and the debtor in possession took an appeal to the District Court. Recognition of a "partial step-back" of Article Nine *filing* rules in favor of the Copyright Act's national registration would have provided a sufficient basis on which to overturn the Bankruptcy Court and give the debtor-in-possession the right to avoid the Bank's security interest in debtor's copyrights, because Capital's state filing was not effective *under Article Nine* to perfect its security interest in the copyright.

Indeed, in reversing the Bankruptcy Court, the District Court that a security interest in a copyright could *only* be perfected by filing in the Copyright Office.[6] However, that point is clearly set out in the applicable state law. Instead of recognizing the propriety of Copyright Act recording under state law, the District Court made a federal case out the proper perfection of a security interest in a copyright. The court passed on the chance to pair the Copyright Office filing mandated by the partial step-back in U.C.C. section 9-302(3)&(4) with the Article Nine priority scheme.[7] According to the District Court, the partial step-back for filing was not enough preemption. Relying on the complete step-back language in section 9-104(a) and the federal preemption doctrine,[8] the Court concluded that all of Article Nine was displaced by the Copyright Act, including its priority rules. According to *Peregrine*, Article Nine did not control perfection or the rights of *any* of the parties, *including the bankruptcy trustee who stands in the shoes of a lien creditor*.[9]

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5 Bankr. LEXIS 2469 at *14 ("Therefore, filing in the Copyright Office is not necessary or effective to perfect a security interest in copyrights, licenses, or the proceeds thereof, against a lien creditor."). *See also* 116 B.R. at 201.

6 116 B.R. at 203.

7 The Bankruptcy Court for the District of Arizona did not pass up the chance in 1997, however. *See In re* Avalon Software, Inc., 209 B.R. 517, 522-23 (Bankr, D. Ariz. 1997).

8 116 B.R. at 202-03 & 199-201. The *Peregrine* Court noted that the 1976 Copyright Act created a federal recording system for copyrights and that the purpose of the system was to "promote national uniformity." 116 B.R. at 199, *quoting*, Community for Creative Non-Violence v. Reid, 490 U.S. 730, 740 (1989). In cases involving copyrights and the *proceeds* of copyrights (copyright-based receivables), the federal system is equipped to handle both the consensual security interest and the nonconsensual levy. According to the Court any competing recording system would hamper the nationwide effectiveness of the federal scheme, . 116 B.R. at 204-08 & n.17.

9 116 B.R. at 205-07.

B. Peregrine and Later Transfer

In order to displace the comprehensive Article Nine priority rules, the Court applied a federal law, which covers the same interests otherwise protected by section 9-301(1)(b) of Article Nine. Within the sparse language of 205(d) of the Copyright Act, the Court found language, which handled the conflict between the secured creditor and the "lien creditor" who was given hypothetical life under section 544(a) of the Bankruptcy Code.[10] The court's construction of section 205(d) of the Copyright Act and resulting analysis of the *Peregrine* opinion is not solid.[11]

Ironically, the *Peregrine* holding that a complete step-back from Article Nine was mandated provided Capital with an argument that would have been unavailable under the Article Nine partial step-back priority scheme. Capital argued that if the Copyright Act completely occupied the priority field, it must have a rule protecting the lien creditor from prior unrecorded transfers, or the unrecorded security interest would prevail in bankruptcy.[12] In order to find that Capital's security interest could be set aside because it was unrecorded under the Copyright Act, the *Peregrine* Court had to identify a priority rule in section 205(d) of the Act that protected a later lien creditor against a prior unrecorded transfer of copyright ownership. Such a rule is clearly set out in Article Nine section 9-301(1)(b).[13] But, given the sparse priority rule language contained in section 205(d) of the Copyright Act, finding the functional equivalent of section 9-301(1)(b) seemed like a tall order.

While the involuntary lien might very well be considered a "transfer of copyright ownership" as broadly defined by section 101 and section 201(d)(1) of the Copyright Act, the priority rule for "conflicting transfers" in section 205(d) does not seem to provide for involuntary transfers. Later transfers which escape the grace period and are first recorded prevail against prior unrecorded transfers only if "taken in good faith for valuable consideration."[14] This language seemingly excludes an ordinary judgment creditor whose involuntary lien is never taken in exchange for consideration provided to the debtor and thus is never "for valuable consideration."[15] The

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10 116 B.R. at 205-06.

11 The lien creditor priority rule under Revised Article Nine is found in Revised section 9-317(a)(2). U.C.C. [Revised] § 9-317(a)(2).

12 116 B.R. at 206.

13 U.C.C. § 9-301(1)(b).

14 17 U.S.C. § 205(d) (1994).

15 It can be argued that a judgment creditor acquires no rights in a federal copyright still owned by the author. Section 201(e) provides that:

Peregrine Court avoided this gap in section 205(d) priority by relying on the *hypothetical***,** and, in this case, *artificial* nature of the lien creditor's special bankruptcy *persona*. Under section 544(a)(1) of the Bankruptcy Code, the trustee has the rights of a judicial lien creditor who also "extends credit to the debtor" on the date of the petition. Based on this artificial, but unavoidable, timing restriction, the Court concluded that the section 544(a)(1) lien creditor did, in fact, "take" for "a valuable consideration" within the meaning of section 205(d) of the Copyright Act.

This is nothing more than questionable finesse around the obvious voluntary transferee-for-value language of section 205 of the Copyright Act. Such logic also runs counter to the policy underlying the hypothetical simultaneous credit extension used to limit the right described in section 544(a)(1) of the Bankruptcy Code.[16] The date of the credit extension in 544(a)(1) coincides with the birth of the lien so that the trustee cannot *advance* the date on which the hypothetical lien creditor extended credit. Without this restriction, the trustee might invent the date of a credit extension to take advantage of the occasional state law giving rights to a creditor who *extends* unsecured credit in the gap between the execution of another creditor's security agreement and the recording or perfection of that interest.[17] This timing language was never intended to permit the trustee to promote the simple lien creditor to the status of a voluntary for-value transferee.[18] Even if

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When an individual author's ownership of a copyright, or of any of the exclusive rights under a copyright, has not previously been transferred voluntarily by that individual author, no action by any governmental body or other official or organization purporting to seize, expropriate, transfer, or exercise rights of ownership with respect to the copyright, or any exclusive rights under a copyright, shall be given effect under this title, except as provided under title 11. 17 U.S.C. § 201(c) (1994). The purpose of this section was to limit the extent of copyright control that the government of the former Soviet Union could exercise over the dissemination of works by Soviet authors of which the government did not approve. The language is much broader than the purpose behind it, however. The language of this section can be read to prohibit any involuntary transfer of an author-owned copyright outside of bankruptcy that relies on governmental action. This reading of section 201(e) should be rejected. Although the parties failed to raise the issue in *Peregrine*, the Court correctly limited section 201(c) to actions *initiated by and for* governmental bodies. 116 B.R. at 205-206, n.16.

[16] Capital argued that the trustee needed the status of a subsequent purchaser to find protection under the priority rule in section 205(d). 116 B.R. at 206.

[17] In *Constance v. Harvey*, 215 F.2d 571 (2d Cir. 1954), *cert. denied*, 348 U.S. 913 (1955), the Second Circuit held that the trustee, as hypothetical lien creditor under section 70(c), could hypothecate a credit extension in the gap between the creation and perfection of a chattel mortgage, even though the mortgage had been filed and perfected before the petition date. The Supreme Court overruled *Constance v. Harvey* in *Lewis v. Manufacturers National Bank,* 364 U.S. 603 (1961).

[18] 4 Collier on Bankruptcy ¶ 544.02 at 544-11 to 544-13 (1986). *See* Paul Heald, *Resolving*

the language of 544(a)(1) can be stretched as *Peregrine* suggests, the trick works only when the *hypothetically created* lien creditor competes with the secured party in bankruptcy; it does not make 205(d) applicable to real involuntary liens that arise well after the debt is incurred under state judicial lien law. In that very important sense, the priority scheme of section 205(d) is incomplete. Despite the gap, however, *Peregrine* finds the priority scheme of section 205(d) sufficient to displace the priority rules in Article Nine.

The mischief that results from finding a lien creditor lurking in the later transfer language of section 205(d) extends far beyond security interests in copyright collateral. If federal law does indeed protect the lien creditor as a "later for-value transferee," then all unrecorded transfers of copyright ownership are vulnerable to the bankruptcy trustee after the grace period has expired.[19] In some cases, these unrecorded or late-recorded transfers may also be vulnerable as preferences under section 547 of the Bankruptcy Code.[20]

C. Peregrine and Security Interests in Receivables

Peregrine mandates that a security interest in copyright royalties, or other receivables generated by a copyright, must be recorded under section 205 of the Copyright Act in order to be "perfected."[21] *Peregrine* assumes receivables generated by copyright collateral are so integral to the copyright ownership rights transferred for security that they must also fall within the preemptive shadow of the Copyright Act. While royalties are clearly important to copyright owners, they do not arise naturally from the federal statutory basis for copyright ownership. Instead they are the direct by-

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Priority Disputes in Intellectual Property Collateral, 1 J. INTELL. PROP. L. 135, 144 (1993)(Copyright Act section 205(d) does not allow the debtor-in-possession to prevail against an unperfected security interest.).

19 11 U.S.C. § 544(a)(1) and § 546(b) (1994).

20 11 U.S.C. § 547(b)&(e) (1994).

21 National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n., 116 B.R. 194, 199 (C.D. Cal. 1990). Applying only a partial step-back to Article Nine filing, the decision in *Avalon Software* also mandates Copyright Office recording for copyright based receivables. See *In re* Avalon Software, Inc., 209 B.R. 517, 523 (Bankr. D. Ariz. 1997). The underlying rationales in the two cases are not the same, however. *Peregrine* seems to treat receivables as a necessary incident to copyright ownership *under federal law*. *Avalon Software* seems to treat royalties as "proceeds" *under state law* that are unperfected if the copyright collateral is unperfected. With respect to the holding in *Avalon Software*, it should be remembered that section 9-306(1), in its present form, requires that a license result in a "disposition" of copyright property before proceeds are generated.

product of private contractual agreements that have traditionally been the domain of state law.[22] Extending the reach of the preemption doctrine to cover generated receivables in *Peregrine* may be more questionable than the use of preemption to displace Article Nine priority rules.[23]

The underlying rationale for the *Peregrine* position on receivables seems to have been trumped by the Ninth Circuit in *Broadcast Music, Inc. v. Hirsch*.[24] In *Broadcast Music* the Court held that an assignment of the right to receive copyright royalties was not a transfer of copyright ownership under section 205(a) of the Copyright Act, and that such assignment did not need to be recorded to defeat a subsequent tax lien.[25] The Ninth Circuit refused to extend its holding expressly to transfers for security, and therefore to *Peregrine*.[26] However, the Ninth Circuit's statement that "[a]ssignments of interests in royalties have no relationship to the existence, scope, duration or identification of a copyright, nor to 'rights under a copyright'" seems to undercut the premise behind *Peregrine's* extension of section 205 preemption to copyright-based receivables.[27] The *Peregrine* Court viewed/characterized the security interest in copyright-based receivables not only as a recordable transfer under the Act, but as a vulnerable recordable transfer absent a recording under section 205(d) [remember *Peregrine* saw a complete preemption].[28] Peregrine's conclusion that receivables not recorded under section 205(a) and (c) lose to the lien creditor under section 205(d), depends on the premise that such receivables fall within the broad definition of a "transfer of copyright ownership." In *Broadcast Music,* the Ninth Circuit found an ordinary assignment of such receivables did not fit within

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22 Aronson v. Quick Point Pencil Co., 440 U.S. 257, 266 (1979); McCoy v. Mitsuboshi Cutlery, 67 F.3d 917, 922 (Fed. Cir. 1995), *cert. denied*, 116 S. Ct. 1268 (1996)(licenses conform to state law); Power Lift, Inc. v. Weatherford Nipple-Up System, 871 F.2d 1082, 1085 (Fed. Cir. 1989)(patent license is a contract to be construed under state law). *See* Robert Rotstein, *Paul Heald's "Resolving Priority Disputes in Intellectual Property Collateral": A Comment,* 1 J. INTELL. PROP. L. 167, 182-83 (1993)(Proceeds derived from copyright are not within the scope of section 106 of the Act and are not "work-based" assets for recordation purposes.).

23 "[Federal law] may not be invoked...merely because...the property involved was obtained under federal statute." Puerto Rico v. Russell & Co., 288 U.S. 476, 483 (1933)(Brackets added). *See* A. Haemmerli, *supra* note 668 at 1680-94. The article soundly refutes the *Peregrine* assumption that federal preemption doctrine mandates section 205 recording and priority apply to security interests in copyright receivables.

24 104 F.3d 1163 (9th Cir. 1997).

25 104 F.3d at 1166 & 1168.

26 104 F.3d at 1166-67.

27 116 B.R. at 199.

28 116 B.R. at 205-07.

that definition. Assignments for security would seem to follow the same logic.

D. Peregrine and Perfection

In a classic example of understatement, Judge Koziniski noted that "filing with the Copyright Office can be much less convenient than filing under the U.C.C." Since a Copyright Office filing is accomplished by reference to the registration number of an existing work. Recording a security interest in the specific copyright assets of a debtor with a fluid inventory of these assets (e.g., a film library) will involve "dozens, sometimes hundreds, of individual filings."[29] As the actual inventory changes, either because different works are bought and sold or because the production of a final work must go through many stages with each stage being a distinct work in its own right, the secured party will be required to make a separate Copyright Office filing for each work added to or deleted from the library. Article Nine, by contrast, provides a blanket notice filing on all after-acquired property, thus giving the creditor a continuing, floating lien on the debtor's copyright without the need for periodic updates.[30]

The link between recording and registration of an "existing work" is not, however, a "Condition of Recordation" under section 205(a) of the Copyright Act. Subsection 205(a) provides that '[a]ny transfer of copyright ownership or other document pertaining to a copyright may be recorded ...."[31] The only condition imposed on recording under subsection (a) is that the document "bears the actual signature of the person who executed it, or ... is accompanied by a sworn or official certification that it is a true copy of the original, signed document."[32] The link arises out of the language in section 205(c) and (d) governing effectiveness of a recording for purposes of priority against subsequent transferees. Under subsection (d) only a recording "in the manner required to give constructive notice under subsection (c)" is good against a "later transfer."[33] In order for a security agreement to provide "constructive notice" under section 205(c) (1) the recorded document must "specifically" identify the copyrighted work so that it can be revealed to a reasonable searcher by title or registration number, and (2) the work must have been registered.[34] Because this definition of "constructive notice"

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29 116 B.R. at 203.

30 U.C.C. § 9-204.

31 17 U.S.C. § 205(a) (1994).

32 *Id.*

33 17 U.S.C. § 205(a) (1994).

34 "...(2) registration *has been made* for the work." 17 U.S.C. § 205(c)(2) (1994) (Emphasis

requires some prior specific identification of the work transferred by the recorded document, in addition to registration of the work, an effective Copyright Act recording cannot effectively reach after-acquired property.[35] If, under *Peregrine*, "federal law (the Copyright Act) preempts state *methods of perfecting* security interests in copyrights and related accounts receivable,"[36] then *all* the notice filing *methods of perfection* in Article Nine must yield to the transaction-specific rules of the Copyright Act. The *Peregrine* view of preemption makes the debt financing of "works in process," a movie in production for example, an intolerable legal gamble for the secured party.[37] Unless the secured party requires the debtor to capture the unfinished collateral project in a sequence of titled "works" which can be separately named, registered, and transferred in a series of recordable documents, the recording provision of the Copyright Act provides no "constructive notice" protection.

The connection between registration and recording may even turn out to be time-sensitive, similar to the manner of real estate recording. While a specific identification of the work *in the recorded instrument* is necessary for an effective Copyright Act recording of a security interest, it is not clear whether the essential section 205(c) *registration* of the copyright must precede the recording in order for the recording to be effective "constructive notice." The critical language of section 205(c)(2) states that "recordation . . . gives . . . constructive notice . . . but only if . . . (2) recordation *has been made* for the work."[38] Under section 205(c)(2) the order in which registration and filing of a security interest occur is critical to enforcement of the rights which one seeks to protect. Registration, at some point in time, is clearly necessary to provide "constructive notice." Furthermore, if the phrase "has been made" in section 205(c)(2) looks back from the date of recording, then a recorded security agreement would *never* be effective as constructive notice unless *preceded* in time by an effective registration of the work.

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added.).

35 17 U.S.C. § 205(c)&(d) (1994). Economically significant financing today tends to be ongoing and fluid, not discrete. In ongoing financing, the transactional approach involves considerably more expense than the notice filing approach because the transactional approach involves multiple trips to the filing office, while notice filing requires only one. .

36 116 B.R. at 199.

37 *See* Steven Weinberger, *Perfection of Security Interests in Copyrights: The Peregrine Effect on the Orion Pictures Plan of Reorganization*, 11 CARDOZO ARTS & ENT. L.J. 959, 975 (1993). (lending banks unable to properly perfect their security interests in the debtor's unreleased films because the films had not been registered within the meaning of section 205(c) of the Copyright Act).

38 17 U.S.C. § 205(c)(2) (1994) (emphasis added).

However, if "has been made" merely looks back from the date when the recording is effective as constructive notice or from the time the constructive notice issue becomes relevant, a recording prior to registration would be effective as long as the work is eventually registered. In such a case, however, the recorded document would only be effective as "constructive notice" under subsection (d) from the time the work was "registered."

The Bankruptcy Court that was overruled by the District Court in *Peregrine* subsequently described the controlling federal system for recording copyrights as one "modeled on real property recording acts."[39] Dicta from that Court's opinion in *In re AEG Acquisitions Corp.* suggests that recordation of a copyright mortgage 14 days before the registration of the underlying copyright might render the recordation invalid because it would be outside the "chain of title."[40] *In re AEG* seems to prefer a literal chronological reading of section 205(c)(2) - a reading which invalidates any recording not preceded in time by a registration. This chronological reading of section 205(c)(2) may not be compelled by the present language, however.

Even where there is an effective *prior* registration of the work, a recording might be outside the chain of title if one or more of the prior transfers leading to the debtor's title remains unrecorded or was not recorded in the proper order. Nothing in section 205(c) requires such a chronological reading of the constructive notice requirement and, in general, copyright law requires only the recording of *the* transfer, which shows the transferee's ownership rights.[41] Unlike real estate law, the Copyright Act does not seem to expose the transferee of a *registered* copyright, who records outside the title chain, to the risk of losing priority to a purchaser who does not locate the copyright transferee's interest.[42] Nevertheless, a security interest in a copyright may be enough of a derivative right to suggest that transfers necessary to locate ownership in the *immediate debtor* must be recorded before a security interest is effective as constructive notice or is properly perfected.

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[39] *In re* AEG Acquisitions Corp., 127 B.R. 34, 41 at n.8 (Bankr. C.D. Cal. 1991), *aff'd*, 161 B.R. 50 (9th Cir. B.A.P. 1993). Two of the works used as collateral in AEG were foreign films. Since the 1988 Amendments to the Copyright Act, registration has not been a prerequisite to maintaining an infringement action on a Berne Convention work. 17 U.S.C. § 411(a) (1994). The 1988 Amendments pertain only to infringement suit prerequisites, however; the amendments did not dispense with registration as a condition for constructive notice of a recorded transfer. 127 B.R. at 42; 161 B.R. at 57.

[40] 127 B.R. at 41 n.8. *But see* Sevarouski Am., Ltd. v. Silver Deer, Ltd., 537 F. Supp. 1201 (D. D.C. 1982). *Sevarouski* involved the state of record title necessary to support an infringement action.

[41] 3 NIMMER ON COPYRIGHT, § 12.02 at 12-59 & 12-60 (1993).

[42] 537 F. Supp. at 1204.

In 1993, Congress considered eliminating the requirement of registration as a constructive notice condition under section 205(c).[43] The proposed Copyright Reform Act of 1993 would have provided constructive notice stature to documents which "identify the work . . . so that it would be revealed by a reasonable search under the title *or* registration number . . . ."[44] However, the Reform Act did not allow for the effective recording of agreements covering after-acquired property, since the recorded document still had to "identify the work." The Reform Act passed in the House of Representatives in late 1993, but failed to win approval in the Senate.[45]

As long as identification of the debtor's intellectual property right is critical to an *effective* recording under section 205, a cautious lender should not rely simply on filing a security interest in the Copyright Office unless the copyright is registered. It would be prudent for the lender to ensure that the record contains any other transfer document necessary to establish the immediate debtor's ownership.

A further practical problem relates to the gap in time between the "date of recordation" of a security interest filed at the Copyright Office and the date on which the document is available for public viewing. The *date of recordation* is the date when the document in proper form is *received* in the Copyright Office.[46] "Recorded" documents are examined, numbered, scheduled and cataloged before they are made available for the public record. Prior to January 1994, the Copyright Office recording backlog averaged about eight months from the time the document was received. Currently, this "office delay" is an average of six months.[47] When this "office delay" is added to the 30-day look-back period, extending credit on the strength of a copyright becomes a time-consuming process. The secured party will not advance funds until the file is clear of possible assignees or secured parties who could claim a prior execution and recording within the grace period. Because recording dates from *receipt* of the recordable document in the Copyright Office, the file cannot be considered clear until the grace period and the "office delay" period have both passed. The language in section 205(a) of the Copyright Act, which links the importance of registration and a recording "in a manner required to give constructive notice," is the basis for

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43 The Copyright Reform Act of 1993, S. 373, 103rd Cong., 1st Sess. § 105(b) (1994).

44 *Id*. (Emphasis added).

45 139 Cong. Rec. H 10308 (November 20, 1993).

46 37 C.F.R. § 201.4(e), § 201.25(e), §201.26(f). *See also* Copyright Office Circular # 12, *supra* at note 393. *But see* 3 NIMMER ON COPYRIGHT, § 10.07[A][1] at n.5 and Patch Factory, Inc. v. Broder, 586 F. Supp. 132 (N.D. Ga. 1984).

47 Conversation between the author and Ms. Maria L. Llacuna, Copyright Document Specialist, Copyright Office, Library of Congress, Washington, D.C. (February 3, 2000).

an argument that Article Nine is not preempted with respect to unregistered copyrights.[48] However, because *Peregrine* concluded that the priority rules in Article Nine are preempted by section 205(d), and subsection (d) applies to all transfers of copyright ownership, registered and unregistered, that are included in subsection (a), the argument runs counter to the preemption doctrine as articulated by the Central District of California Court.[49] In any case, given the broad preemptive effect of section 205(a),[50] the constructive notice standard in subsection (c) will probably be seen as part of the *recording requirements* for all copyrights, not a limitation on the reach of preemption. Indeed, the Bankruptcy Court for the District of Arizona has rejected the registered-unregistered distinction in an opinion that adopts only a partial step-back for Copyright recording.[51]

E. Peregrine and Priority

The limitations on security interests inherent in the section 205 recording scheme are exaggerated when the priority rules in subsections (d) and (e) are applied to secured party conflicts. The single transaction structure, the long look-back period, and the built-in office delay that characterize Copyright Office recording all work mischief in the operation of the priority rule contained in section 205(d). First, section 205(d) has a very different set of axioms for "transfers of copyright ownership" than those provided for security interests in Article Nine. The first transfer *executed*, rather than the first to file, has priority under the Copyright Act as long as "constructive notice" of the transfer is given through a Copyright Office recording within one month of its execution in the United States, two months of its execution outside the United States, or at any time prior to a later competing transfer.[52] Otherwise, the later transfer has priority under the Copyright Act if it is recorded first in a manner sufficient to give constructive notice,[53] and if such transferee takes (1) in good faith, (2) for

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48 A. Haemmerli, *Insecurity Interests: Where Intellectual Property and Commercial Law Collide*, 96 COL. L.REV. 1645, 1667-68 (1996).

49 *See* Maljack Productions, Inc. v. GoodTimes Home Video Corp., 81 F.3d 881, 888 (9th Cir. 1996).

50 17 U.S.C. § 205(a) (1994)("Any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office....").

51 *In re* Avalon Software, Inc., 209 B.R. 517, 522-23 (Bankr. D.Ariz. 1997). However, *Avalon Software* views the constructive notice language in section 205(c) as part of the filing, not priority, provisions of the Copyright Act. *See* discussion in THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE, § 2:81 (2000).

52 17 U.S.C. § 205(d) (1994).

valuable consideration, and (3) without notice of the earlier transfer.[54]

If the first secured party is also the first transferee from the debtor-owner, the secured party has priority over all "conflicting transfers" as long as the security agreement is recorded in the Copyright Office within 30 days or 60 days of its execution, as appropriate. However, because the recorded secured party can never be sure of the that it is the first transfer, the subsection (d) look-back compels lenders to record and then wait out a hypothetical prior party's "grace period" and the "office delay period" between receipt of the hypothetical prior party's document and its inclusion in the record.[55] The secured party's commitment to loan in the security agreement must be conditioned on a clean file after these periods have expired.[56]

The race-notice character of the section 205(d) priority rule and the limitations imposed on the "between two transfer" scope make its application awkward when the rights of successive secured parties must be sorted out. Anytime more than two conflicting transfers are involved, the section 205(d) rule can produce a circular priority problem.[57]

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[53] The requirement that the subsequent transferee record "in such manner" obviously refers only to the manner required to give constructive notice under subsection (c), but not to the 30-day or 60-day grace period. *See* 3 NIMMER ON COPYRIGHT, § 10.07[A][4] at 10-58 to 10-59 (1993).

[54] 17 U.S.C. § 205(d)&(e) (1994); 537 F. Supp. at 1203, 1204. When both transfers are unrecorded, the first to execute seems to prevail under section 205(d) because the preemptive priority of the second transfer is dependent on recording.

[55] To the grace period (30 or 60 days), the secured party must add the "office delay" between copyright "recordation" and the date on which the transfer document is actually viewable. *See supra* text accompanying notes 686-688. Assume that the debtor executes a security transfer to the secured party on June 2. If that document, in proper form, is received in the Copyright Office on that same date, it will have a June 2 recording date as well. However, if a conflicting transfer was executed by the debtor on June 1, the earlier transferee will have priority over the secured party as long as the earlier transferee records (document received in the Copyright Office) by July 1. However, because that recording may not be known to the secured party until it appears on microfilm (one or two months later) the secured party should not disburse funds or release goods until that additional time beyond July 1 has passed.

[56] Subsequent transfers are protected if they are "for a valuable consideration." 17 U.S.C. § 205(d) (1994).

[57] The following fact pattern illustrates circular priority under section 205(d):

(1) On June 1, Copyright Owner executes security interest transfer to **X**.

(2) On June 10, Copyright Owner executes security interest transfer to **Y**.

(3) On June 15, Copyright Owner executes security interest transfer to **Z**.

(4) On June 30, **Z** records in the Copyright Office.

(5) On July 5, **X** records in the Copyright Office.

The subsection (d) priority rule is double-qualified in a way that makes it unclear who the winner is when the prior transfer does not make a timely recording and, at the same time, the later transfer fails to met the BFP-like statutory qualifications. Whenever a prior executed interest fails to record within the 30-day period (or 60-day period), a subsequent security interest must record first and take in "good faith" and "without notice" to qualify for priority under the last sentence of section 205(d). It is unclear what the section provides when the first transfer fails to record within the grace period and the later transfer records first but does not take in good faith or without notice. The later transfer does not qualify under the "prevails" mandate of the last sentence, but the earlier transfer does not qualify under the rule protecting the first to execute, either. To "prevail," the first executed transfer must either record within 30 days or "before . . . the later transfer."

The same problem arises whenever the later transfer is not taken for valuable consideration. When the competing transfers are *security interests*, the "without notice" and "for valuable consideration" conditions in the last sentence of section 205(d) create a very different priority scheme from the pure race provisions which control in contests between secured parties under Article Nine. The cases under the Copyright Act seem to hold subsequent transferees to a fairly rigorous inquiry obligation as part of the subsection (d) "without notice" standard.[58]

The "valuable consideration" requirement in subsection (d) adds the further condition of either a present payment or an absolute obligation incurred by the "later transfer" at the time of such transfer.[59] The "binding promise to pay royalties" language was added as a qualifying "value" option in 1976 because conditional obligations that were not in fact executed or absolute did not satisfy the 1909 Act's definition of valuable consideration.[60] It is unclear how the "valuable consideration" qualification will be applied to subsequent secured parties under the priority scheme mandated by *Peregrine*. The "value" requirement for secured parties under Article Nine is

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(6) On July 8, **Y** records in the Copyright Office. In this example, if we assume that **Y** and **Z** took their interests in good faith, without notice and for valuable consideration: **X** has priority over **Y** because, although **X** did not record within the 30-day grace period, **X**'s interest was executed first and **X** filed before **Y**. **Y** has priority over **Z** because, *between the two*, **Y** executed first and recorded within the 30-day grace period. **Z**, the last to execute, has priority over **X**, the first to execute, because **X** failed to record within the 30-day grace period and, between the two of them, **Z** won the race to the Copyright Office. The result does not change if some or all of the transfers in the example are assignments or exclusive licenses rather than transfers for security.

58 3 NIMMER ON COPYRIGHT, § 10.07[A][2] at 10-54 to 10-56 (1993).

59 3 NIMMER ON COPYRIGHT, § 10.07[A][3] at 10-56 (1993).

60 *Id.*

satisfied whenever the security interest is taken for an antecedent debt.[61] *Peregrine* notwithstanding,[62] the transfer of a security interest in a copyright to secure an antecedent debt *would not* be taken for a "valuable consideration" under section 205(d) of the Copyright Act.[63] It appears that a subsequent secured party who did not give "new value" would never be able to trump a prior transfer, including a prior secured party, even when that prior transfer is never recorded.[64] The best argument available to a subsequent secured party who took the interest for an antecedent debt is that once the subsequent interest is recorded in the Copyright Office before the prior transfer, the priority contest becomes a tie because the prior transfer seems to lose its argument for priority when it loses the race to record after the grace period has expired.[65] However, in the case of such a stalemate, the Court may go outside the recording statute and award priority to the first to execute.[66]

The priority rule covering priority between a transfer of copyright ownership and a nonexclusive licensee in section 205(e) can be a trap for the secured party as well. Under *Peregrine*, if a security interest in a copyright is indeed a "transfer of copyright ownership," then the priority between such a security interest and a nonexclusive license is controlled by section 205(e) of the Copyright Act. Under subsection (e), the licensee prevails if the license is evidenced by a signed instrument and is either: 1) taken before the execution of the security agreement, or 2) taken after an unrecorded security transfer, if the licensee takes in good faith and without knowledge.[67] Unlike

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61 U.C.C. § 9-203(1)(b) & § 1-201(44).

62 Recall that the *Peregrine* Court concludes that the hypothetical lien creditor under section 544(a) of the Bankruptcy Code draws rights from section 205(d) of the Copyright Act because such a lien creditor can be "deemed" a *transfer taken for valuable consideration.* 116 B.R. at 207. Such "deeming" is made possible by the statutory characterization of the hypothetical lien creditor in section 544(a)(1) as one who "extends credit" and "obtains ... a judicial lien simultaneously at the "commencement of the case." 11 U.S.C. § 544(a)(1). *See* discussion *supra* Section III(b)(3)(B). In dicta, the Court also notes that the lien of a judgment creditor "is deemed to be in exchange for the claim that formed the basis of the underlying judgment, a claim that is extinguished by the entry of the judgment." This reasoning is suspect. The judgment creditor's claim may merge in the judgment but that does not provide the lien with "for value" status. Under that logic, all judgment creditors might claim their liens were obtained for new value.

63 17 U.S.C. § 205(d) (1994).

64 *Id.*

65 *Id.*

66 *See* Ice Music, Ltd. v, Schuler, 42 U.S.P.Q.2d 1449, 1454 (U.S.D.Ct. S.D.N.Y. 1996)(Under section 205(e), "[assignor] was not 'the owner of the rights licensed' at the time [nonexclusive licensee] allegedly received money and ... signed the Receipt....")

67 17 U.S.C. § 205(e) (1994).

the secured party, the nonexclusive license is *not* a transfer of copyright ownership that invokes the writing requirement in section 204 of the Copyright Act.[68] Therefore, an oral transfer of a nonexclusive license is effective.[69] However, for such a nonexclusive license to have priority over subsequent "ownership" transfers as well as prior unrecorded "ownership" transfers, it must be evidenced by a signed writing.[70] While section 205(e) does not expressly date the nonexclusive license by the date of the evidencing writing, there is case law to that effect.

In *Ice Music, Ltd. v. Schuler*[71] the United States District Court for the Southern District of New York held that the execution of the necessary writing evidencing the nonexclusive license must precede the ownership transfer under 205(e)(1).[72] If a prior oral license loses to a competing ownership transfer at the time of transfer, a subsequent nonexclusive BFP licensee would seem to suffer the same fate if the writing requirement is not satisfied when the prior transfer is recorded under section 205(e)(2).

As explained in Part II(e)(2)(B), Revised Article Nine makes express provision under state law for the priority of a security interest as against conflicting licensees from the debtor licensor. Three principal priority rules for secured parties and licensees can be derived from the Revisions:

1. A subsequent licensee prevails over any prior secured party to the extent that the license was a disposition authorized free and clear of the security interest.73 Furthermore, the Revised definition of "proceeds"74 indicates that even a nonexclusive

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68 17 U.S.C. § 101, "transfer of copyright ownership" (1994); 17 U.S.C. § 204 (1994).

69 3 NIMMER ON COPYRIGHT, § 10.02[B][5] at 10-25 (1993).

70 17 U.S.C. § 205(e) (1994). Section 205(e) works better than Article Nine when the nonexclusive license is a contingent one used to carry out the provisions of an escrow agreement covering copyrighted source code. The escrow agent holds the source code as security for the licensee against the licensor's performance of the main licensing agreement. If Article Nine applied, this security interest in a source code license might have to be filed as a "general intangible" in order to defeat a subsequent bankruptcy trustee. Under the preempting copyright rule in section 205(e), however, no filing or recording is necessary as long as it is a nonexclusive license in the source code that is conditionally available on default. Only a writing is required.

71 42 U.S.P.Q.2d 1449 (U.S.D.Ct. S.D.N.Y. 1996).

72 42 U.S.P.Q.2d at 1454 (Under section 205(e), "[assignor] was not 'the owner of the rights licensed' at the time [nonexclusive licensee] allegedly received money and ... signed the Receipt . . .")

73 U.C.C. [Revised] § 9-315(a)(1).

74 U.C.C. [Revised] § 9-102(a)(64)(A)("whatever is acquired upon the sale, lease, *license*, exchange, or other *disposition* of collateral ...")(Emphasis added).

license can qualify as an authorized *disposition*.[75]

2. Even if the license is not authorized by the secured party, a subsequent nonexclusive licensee in the ordinary course of business takes free of the security interest even if the licensee is aware of the interest.[76]

3. Even a subsequent licensee that does not take under an authorized license or under the ordinary course rule will prevail to the extent that it "gives value without knowledge of the security interest and before it is perfected."[77]

Because *Peregrine* teaches that a security interest is a "transfer of copyright ownership,"[78] these rules appear to be currently displaced in favor of the priority scheme in section 205(e) of the Copyright Act.[79] Note that the proposed "Federal Intellectual Property Security Act,"[80] would remove the priority conflict between the secured party and the nonexclusive licensee from section 205(e) and make Article Nine applicable.[81]

In re Avalon Software, Inc.

A. The Avalon Holding

In a case decided seven years after the Arizona Bankruptcy Court, in *In re Avalon Software, Inc.*[82] concluded that a reconciliation of the Copyright Act and Article Nine did not require complete preemption of Article Nine's priority rules. *Avalon Software* finds that the partial step-back under U.C.C.

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75 U.C.C. [Revised] § 9-315(a)(1).

76 U.C.C. [Revised] § 9-321(a)&(b).

77 U.C.C. [Revised] § 9-317(d).

78 17 U.S.C. 101 (1994).

79 116 B.R. at 205.

80 Task Force on Security Interests in Intellectual Property, Business Law Section, American Bar Association, DRAFT, FEDERAL INTELLECTUAL PROPERTY SECURITY ACT (March 1, 1999)[hereinafter referred to as TASK FORCE DRAFT - FEDERAL INTELLECTUAL PROPERTY SECURITY ACT].

81 TASK FORCE DRAFT - FEDERAL INTELLECTUAL PROPERTY SECURITY ACT, *supra* note80 at SECTION 4(a)(3).

82 209 B.R. 517 (Bankr. D. Ariz. 1997).

section 9-302(3)(a) and (4) is more compatible with the scope of federal preemption. For the lending bank that failed to make any recording in the Copyright Office, however, the distinction between full and partial step-back was academic. The Court held that the bank's security interest in all the debtor's copyrighted and copyrightable software was unperfected on the date of the petition because it had not been recorded in the Copyright Office under section 205(a) of the Copyright Act.[83] However, after finding that the bank's filing of a U.C.C. financing statement left copyright collateral unperfected, the opinion departed from the complete preemption rationale of the *Peregrine* decision. Instead, *Avalon Software* relied on Article Nine section 9-301(1)(b) (not section 205(d) of the Copyright Act) for the proposition that an unperfected security interest is subordinate to the trustee asserting the rights of a hypothetical lien creditor.[84] In addition to recognizing the vitality of U.C.C. priority rules, the Court also concluded that the Article Nine concept of attachment was not preempted by the Copyright Act.[85]

This more limited approach to preemption has its own problems. In essence, *Avalon Software* concludes that section 205(c)'s proviso on constructive notice (specific identification of the work in the recorded document and registration of the work) is part of the displacing *recording* requirements of the Copyright Act. Recall that the elements of constructive notice under section 205(c) are not actually required in order to make a subsection (a) recording.[86] These requirements arise only within the context of the Copyright Act's priority rule in section 205(d).[87] If, contrary to *Peregrine*, the priority rule in subsection (d) does not displace Article Nine priority provisions, it can be argued that constructive notice under subsection (c) should not be required if the security interest is otherwise properly recorded in the Copyright Office under section 205(a). Nevertheless, *Avalon Software* concludes that "ultimate *perfection"* depends upon registration of the software product.[88] The *Avalon Software* opinion sees registration as part

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83 *Id.* at 523-24.

84 *Id.* at 521.

85 *Id*. at 522-23.

86 *See* discussion in PRELIMINARY REPORT #1, AN OVERVIEW OF THE CURRENT LEGAL RULES AND STRUCTURES GOVERNING THE PERFECTION AND PRIORITY OF THE SECURITY INTERESTS IN INTELLECTUAL PROPERTY AND AN ANALYSIS OF PROPOSED LEGISLATIVE REFORMS at Section III (b)(3)(D) (Cooperative Contract - U.S.P.T.O. and Franklin Pierce Law Center 2000).

87 Id. It can even be argued that subsection (c)'s constructive notice requirement is not critical to a recording for purposes of the nonexclusive licensee rule in subsection section 205(e).

88 209 B.R. at 522. Recorded documents that could not be tied to an existing registration

of the secured party's U.C.C. section 9-302(4) "compliance" with the national recordation system that displaces Article Nine filing under section 9-302(3)(a).[89]

This aspect of the partial step-back can be problematic. The relationship between Copyright Act recording, with its attendant registration requirement, and the controlling Article Nine rules on "attachment" is unclear when after-acquired copyright collateral is involved. According to *Avalon Software*, federal copyright law does not alter the secured party's right to acquire an interest in the debtor's after-acquired copyright collateral under an agreement executed before the debtor acquires rights in the collateral.[90] Even if an after-acquired property clause is effective to create an interest in the debtor's later-acquired copyrights, perfection requires compliance with section 205(d) and (c) of the Copyright Act.[91] *Avalon Software* suggests that the secured party could have recorded a security agreement covering after-acquired copyright collateral and then, without the need of a further recorded document, been perfected in such later-acquired property by registering the new works as they came into existence.[92]

However, constructive notice under subsection (c) requires more than a recorded document with advance notice of a security interest and a subsequent registration of the work. Subsection (c) requires that the recorded document, or material attached to it, *specifically identify the work to which it pertains*.[93] A document in the form of a security agreement covering after-acquired property could not satisfy the "specific identification" requirement as to copyright collateral subsequently acquired by the debtor. A subsequent registration of the new collateral does not cure the problem with the prior recorded security agreement.[94] Despite this confusing dicta in *Avalon Software*, a secured party who wants perfection in after-acquired property would be well advised to get the debtor to sign a new agreement that specifically identifies the new work, register the new work, and record the new agreement. While *Avalon Software's* partial step-back approach may cause less preemption mischief than *Peregrine*, clearly one of the

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would be harder to find in a typical copyright search.

89 209 B.R. at 521. U.C.C. § 9-302(3)(a),(4)& cmt. 8.

90 209 B.R. at 522-23.

91 *Id.*

92 "If Imperial Bank had merely done what the law requires - that is, to record evidence of its security interest in the U.S. Office of Copyright - and had it made sure that the after-acquired property had been registered, it would have been found to be perfected." 209 B.R. at 523.

93 17 U.S.C. § 205(c) (1994).

94 17 U.S.C. § 205(c) (1994).

pitfalls is the meshing of the facile Article Nine law on subsequent attachment with single transaction document recording.

B. Avalon and the Definition of Collateral

While the Court in *Avalon Software* properly rejects the argument that unregistered copyrights are not within the scope of section 205,[95] the opinion goes too far in its holding that all *copyrightable* collateral must be recorded under the Copyright Act.[96] Under the current state of the law, copyrightable software that has its principal intrinsic value as a trademark or as a trade secret should be perfected by filing under the U.C.C.[97] even if it is also copyright protected. While the partial step-back approach seems more consistent with the intended scope of section 205 of the Copyright Act, it still requires that copyright collateral be distinguished from other valuable intangible rights in works that may qualify for more than one form of protection.[98]

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[95] 209 B.R. at 522-23.

[96] 209 B.R. at 523-24.

[97] Trade secret software fits the definition of a "general intangible" under section 9-106. See U.C.C. § 9-106.

[98] *See* discussion in PRELIMINARY REPORT #1, *supra* note 86 at Section VI(b). An argument against reform has been made by the Motion Picture Association of America. The M.P.A.A. position is discussed in PRELIMINARY REPORT #1, *supra* note 86 at footnote 754.