INTELLECTUAL PROPERTY SECURITY REGISTRATION AND THE REPORT OF THE U.S. COPYRIGHT OFFICE ON COPYRIGHT AND DIGITAL DISTANCE EDUCATION

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS AND INTELLECTUAL PROPERTY

OF THE

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CONTENTS

HEARING DATE

APPENDIX

INTELLECTUAL PROPERTY SECURITY REGISTRATION AND THE REPORT OF THE U.S. COPYRIGHT OFFICE ON COPYRIGHT AND DIGITAL DISTANCE EDUCATION

THURSDAY, JUNE 24, 1999

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS AND
INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to call, at 2:05 p.m., in Room 2141, Rayburn House Office Building, Hon. Howard Coble [chairman of the subcommittee] presiding.

Present: Representatives Howard Coble, Elton Gallegly, William L. Jenkins, Edward A. Pease, Howard L. Berman, Rick Boucher, William D. Delahunt.

Staff present: Debra Laman, Counsel; Eunice Goldring, Staff Counsel; Sampak P. Garg, Minority Counsel; Bari Schwartz, Minority Counsel; and Stephanie Peters, Minority Counsel.

OPENING STATEMENT OF CHAIRMAN COBLE

Mr. COBLE. Good afternoon, ladies and gentlemen. The subcommittee will come to order. Today we are here to discuss two important issues. First we will turn our attention to the report of the U.S. Copyright Office on Copyright and Digital Distance Education.

Next, we will discuss the issue of Federal intellectual property security interest registration.

Distance education, a form of education where students are separated from the instructors by time and/or space, is expanding rapidly on all levels of education and involving all types of students. Advanced digital technology has created exciting possibilities in education and markets for online educational products. For example, students that are physically removed from an educational institution or not able to attend regular classes due to time constraints have the option to enroll in classes on-line.

With the increased amount of distance education there, is also an increased amount of copyrighted material traveling on-line, creating new risks to the copyright owners. The Copyright Act contains provisions outlining permissible uses of copyrighted material for educational purposes, but they are over 20 years old and may need to be updated to ensure a proper balance between the rights of copyright owners and users' rights of access to information.

In the 105th Congress, the Digital Millennium Copyright Act of 1998 was enacted into law. The act instructed the U.S. Copyright Office to conduct a study on digital distance education and to report back to the Congress in 6 months. The Copyright Office reported to Congress in May 1999.

The report of the U.S. Copyright Office on Copyright and Digital Distance Education is a comprehensive report on the major issues surrounding distance education. The oversight hearing on the report is intended to explore the issues raised by the report and to discuss the Copyright Office recommendations for legislation to update the Copyright Act to facilitate the growth of distance education, yet protect copyright owners' rights.

The issue of adopting a Federal intellectual property security interest registration system deals with a complex combination of intellectual property law and State law of security interests, usually the UCC.

Creators often need financing in order to fund projects, such as filming a movie or developing software. Lenders typically obtain a security interest in the intellectual property product to protect themselves as against other creditors in the event of a bankruptcy. Until recently, lenders did this by filing a security interest with the Secretary of State in the State where the debtor is located. However, two recent cases in the ninth circuit have created uncertainty as to how to file a security interest in copyrighted material. These cases held that because the Copyright Act provides for recordation of transfers of interests in copyrighted works, the Copyright Act preempts State law, even as to the filing of security interests. Therefore, in order to perfect a security interest, it would have to be filed with the Copyright Office. The resulting confusion among creators, lenders, and the U.S. Copyright Office has brought us here today.

We will discuss two proposals to resolve this issue. The American Bar Association has proposed a comprehensive and uniform system for all types of intellectual property. The Commercial Finance Association has proposed an interim fix that would reverse the ninth circuit cases until more comprehensive legislation is enacted. It is important for Congress to ensure that United States creators are able to get financing for their projects and that lenders feel safe in backing them.

I am now pleased to recognize the ranking member of the subcommittee, the gentleman from California, Mr. Howard Berman.

Mr. BERMAN. Thank you very much, Mr. Chairman, for holding this oversight hearing. One of the most exciting and important aspects of the information age is the ability to provide education to those who currently have no means to obtain an education, either for economic or geographic reasons, and to expand and improve the access to education to those who have presently less than ideal access.

I know that kids in my district need greater opportunity to make the school-to-career transition. These kids have a wide variety of choices to get an education that can help them move into productive careers in electronics, the building trades, culinary or computing. Many of these kids don't want to go to a university. Everybody who wants to go to a university should be able to, but many want something different. I see a role for distance education in meeting this need.

I know that in communities throughout the U.S., distance education can substantially improve the quality and variety available in education. And I certainly appreciate the possibilities of providing education to people who don't have access to any education here in the United States and in underdeveloped and developing countries throughout the world. So I have great hope and expectation for the development of new and better distance education programs.

I do have some questions about the need at this particular moment for a change in copyright law to accommodate this growing field.

In setting the stage for its recommendations, the Copyright Office, from whom we shall hear in a moment, observes that education through digital means is rapidly growing and, quote, "Growing pains must be tolerated to give market mechanisms the chance to evolve in an acceptable direction," end of quote. They also observe that, quote, "Sophisticated technologies capable of protecting content are just now in development or coming to market," end of quote, and quote, "Licensing systems are evolving. The challenge in making recommendations at this time is to determine how to set policy during such a period of flux," end of quote.

And they further note that if technology were further along, broadening exemptions could be less dangerous to copyright owners. If licensing were further evolved, broadening exemptions could be less important for educators.

I understand the reasoning for some of the changes the Copyright Office is proposing and I am not suggesting that aspects of these proposals are without merit. With the explosion of digital communications, we have to reexamine how copyright law applies. But in each case, with the rapid development in technology, we should first ask: Is now the right time for government to become involved? If this industry is in its infancy, growing pains are expected and technological mechanisms are just around the corner, is now the time for legislation? Do we have a good perspective on the landscape of distance education? In this rapidly changing landscape, we should be careful in altering the longstanding laws protecting the rights of intellectual property owners. And from reading the Supreme Court decision in this morning's paper, it doesn't matter what we do anyway as to a large number of potential distance educators.

But a second question I would ask is: If we find the time is right for legislation, then are the Copyright Office's recommendations in order? Are they the ones we should proceed with?

Mr. Chairman, I note in our audience today one witness and one non-witness but two former members of this committee, two very distinguished and excellent members of this committee, Ms. Schroeder and Mr. Mazzoli, and it is good to see both of them again. It brings back old times, some of which when we were on that side of the aisle.

Thank you very much for holding the hearing again, Chairman Coble. I look forward to the witnesses.

Mr. COBLE. Thank you, Howard. I want to reiterate what Mr. Berman said about Pat and Ron, it is good to have them both. They both served on this committee, as Mr. Berman said, and they will be recognized in more detail subsequently.

I am going to have to meet with constituents at two different points in this hearing, so don't think that my brief absence indicates lack of interest. I will either ask Mr. Berman, or if one of my Republican colleagues shows up, to chair in my absence.

You all know that we pretty rigidly adhere to the 5-minute rule. I have been taken to task by some people about that, because they didn't know that all witnesses are told prior to coming here that they are asked to reduce their oral testimony to 5 minutes. Now, folks, that is not to say that we are going to cut you off in the middle of a sentence or that we will haul in the U.S. Marshal to apprehend you if you go 6 or 7 minutes, but when that red light illuminates in your eye, that is an indicator to you that it is about time to wrap it up. Now, your written testimony, folks, will be examined in detail; has been and will be.

Our first witness is unknown probably to no one in the room. Or, if so, the uninformed have been living under a rock. We are pleased to welcome back the Honorable Marybeth Peters who is the Register of Copyrights for the United States. She has also served as acting general counsel of the Copyright Office and as chief of both the examining and information and reference divisions. She has served, as well, as a consultant on copyright law to the World Intellectual Property Organization and authored *The General Guide to the Copyright Act of 1976*. The subcommittee has copies of Ms. Peters' testimony which, without objection, will be made part of the record. And, Ms. Peters, it is good to have you back in 2141.

STATEMENT OF MARYBETH PETERS, REGISTER OF COPYRIGHTS, COPYRIGHT OFFICE OF THE UNITED STATES, THE LIBRARY OF CONGRESS

Ms. PETERS. Thank you, Mr. Chairman, members of the subcommittee. I am pleased to be here to testify on our recommendations with respect to digital distance education. You noted that we delivered our report in May, and we did make a number of recommendations to update current educational exemptions to cover certain educational activities taking place through digital technologies.

As we said, distance education in the United States is vibrant and burgeoning. While the concept dates back to the correspondence courses of the 19th century, it is the capabilities of digital technology to deliver instruction to students removed from the instructor in time and space that has vastly increased its appeal and potential.

Today's digital distance education involves copyrighted works being used in new ways, providing new benefits for students and teachers, but also posing new risks for copyright owners. Educational institutions and copyright owners see distance education as a potentially lucrative market. Licensing of copyrighted works in this market will be important. However, exceptions and fair use play a role.

In considering these issues, we focused on two exemptions applicable to educational uses: their use and the specific exemption in 110 for educational broadcasting. This provision was written more than 20 years ago, before the advent of computer networks and personal computers. The question is whether it still strikes the appropriate balance of interest.

This analysis that we did was complicated by time. It is a time of rapid development in both technologies and markets. Many of the concerns on all sides stem from the inability to depend on effective functioning of technological protection and licensing mechanisms. The tools for both exist today. It will become clearer in the next few hours how successfully they can be integrated into the real world of distance education.

As a fundamental premise, the Office believes that emerging markets should be permitted to develop with minimal government regulation. This does not mean, however, that the law must remain frozen. When a statutory provision that is intended to balance interest becomes obsolete due to changes in technology, it may require updating if the policy behind it is to continue. In our view, if that basic policy balance struck in 1976 is to continue, section 110(2) must be updated.

We recommended several changes and additions to the law and also some legislative history. First, we said update the exemption to accommodate the technical requirements of digital transmission over computer networks by making it clear that the term "transmission" in section 110(2) covers such transmission, and by expanding the rights to cover in the exemption those that are needed to accomplish computer network transmission to the extent technologically required.

Second, eliminate the physical classroom requirement in section 110(2). Because instruction can take place anywhere, this limitation has become obsolete. We recommend permitting transmissions to students officially enrolled in the course, regardless of their physical location.

Third, add language that focuses more clearly on the concept of mediated instruction. This would ensure that the performance or display is analogous to the type of performance or display that would take place in a live classroom.

Fourth, because digital transmission poses far greater risks of uncontrolled copying and dissemination, add a number of safeguards as conditions on the applicability of an expanded exemption. These include permitting the retention of transient copies only to the extent that they are necessary to accomplish this transmission.

Because I see the yellow light going on, I am just going to quickly say that we also have a recommendation with regard to retaining the nonprofit requirement for eligibility and adding a section to 112 for ephemeral recording. Our most controversial recommendation has to do with expanding categories of works that are to be covered by an exemption, and then we deal with fair use and say that we think that additional legislative history would be helpful.

What I would like to do is turn to, because you asked me to do a second topic which had to do with perfecting security interest——

Mr. COBLE. If you will suspend a minute. You have been very diligent in your previous visits here and have never abused the 5-minute rule, and since you are addressing two topics, we will cut you some slack.

Ms. PETERS. Thank you. Two very complicated topics, I might add. I have been asked to present our views on the proposal by a task force of the American Bar Association for a Federal Intellectual Property Security Act. The proposal, as you noted, is in response to issues raised by the 1990 *Peregrine* case. That case held that the only way to perfect a security interest in copyrighted works was to record the security interest in the Copyright Office. The basic holding was unremarkable and, we believe, correct. In fact, the drafters of the 1976 act intended that all assignments of copyrights, including security interests, be recorded in the Copyright Office in order to create a single comprehensive registry of claims to copyright and of transfers of copyright ownership.

Nevertheless, *Peregrine* was not received favorably in many quarters, especially by lenders who prefer to perfect their security interest and copyright under State law by filing UCC–1 forms with secretaries of state.

The proposal apparently is designed to address the concerns of lenders who wish to avoid the more exacting requirements of the office's recordation system and instead to utilize the much easier but much less informative UCC system. It also addresses the concerns of some copyright owners who believe it would be easier to borrow funds that they need if their lenders can perfect their liens using the UCC system.

The proposal would permit lenders to perfect security interests in copyrights, in fact all Federal intellectual property rights, with a UCC filing at the State level. Alternatively, they could perfect their security interest by filing something called a Federal financing statement, something similar to a UCC–1, with the Copyright Office or, for that matter, with the Patent and Trademark Office or the Plant Variety Protection Office if the security interest pertains to the rights administered by those offices.

The current system for recording transfers of copyright other than security interest would not be altered except that the 1-month grace period for filing a document would be eliminated in favor of a first-to-file system. Transfers secured through a default of a security interest would be recorded by filing financing statements rather than recording the actual document of transfer.

We contacted representatives of a number of copyright industries to hear their views on the current system and the ABA proposal. Despite the publicity that has been given over the past few years to the criticism of *Peregrine*, we learned that most copyright owners are satisfied with the basic framework of the current system, even after *Peregrine*, and that they oppose the ABA proposal. The consistent theme was that copyright owners prefer the convenience of being able to search all rights pertaining to a copyright in a single office rather than having to search our records as well as the records of one or more State secretaries of state. They also prefer having access to the actual document of transfer so that they can determine for themselves what rights have been secured or transferred, rather than having access only to a financing statement that is much less informative. And they prefer the current system that records rights in specific works rather than a system based on vague statements of liens on a party's intangibles or intellectual property rights.

We do not profess to be experts in secured transactions nor do we presume to speak to the merits of the proposal insofar as it may address the needs of reforms in the patent and trademark areas. Based on our experience and expertise in administration of the copyright law, we do have serious concerns about the changes that the proposal will impose on the current system.

Some of our particular concerns which are set forth in greater detail in our written testimony are, one, the proposed changes in the system for recording copyright transfers other than security interests. Two, permitting perfection of security interest without requiring specific identification of the work secured. Three, making an exception for security agreements to the requirement that the actual document embodying the transfer of copyright be submitted for recordation. Finally, we are also concerned that the proposal provides for the coexistence of dual State and Federal systems for recordation of security interest.

We are certainly not here to defend the current system as perfect. We know that some needs of lenders and copyright owners are not being met. For example, the current system does not address the problem of after-acquired property, an issue of particular interest to venture capitalists and start-up companies. We do not, however, come here with a solution to the problem. The proposal is designed to address that solution, but it does so in a way that to meet the needs of one segment of copyright owners and their lenders, it would seriously weaken a system that serves the needs of the vast majority.

Although we believe that the ruling in *Peregrine* was fundamentally correct, we do not believe that a correct reading of current law necessarily supports the conclusion that Federal copyright law preempts State methods of perfecting security interests in accounts receivable relating to copyrights. We understand that much of the dissatisfaction relates to that part of the case.

Serious consideration should be given to clarifying that security interests in royalties and receivables may be recorded at the State level, even though a copyright may be lurking in the background. We also recognize that secured lenders desire to establish the priority of their liens vis-a-vis other lenders by resorting to the UCC system that they use every day. We do not believe that it would necessarily do violence to the statutory scheme if security interests could be perfected at the State level for the limited purposes of establishing priority among competing security interests. However, we believe that a secured creditor who wishes to secure his rights against the entire world, including those who have purchased rights in a copyrighted work, should be required to use the office's centralized system.

In conclusion, we believe that enactment of the ABA proposal would change many established practices which continue to serve the interest of most copyright owners and others who need access to information about copyright owners. We would not oppose changes where a broad consensus has been achieved but we believe that many of the changes proposed are controversial.

Today's hearing serves a useful function as a starting point for discussion and debate about these issues, but we believe any changes should be considered only after a careful study of the current system of the needs of copyright owners, creditors, and other users of the recordation system, and of the desirability and feasibility of changing the system that has so long served the interest of the copyright community.

Thank you.

Mr. COBLE. Thank you, Ms. Peters.

[The prepared statement of Ms. Peters follows:]

PREPARED STATEMENT OF MARYBETH PETERS, REGISTER OF COPYRIGHTS, COPYRIGHT OFFICE OF THE UNITED STATES, THE LIBRARY OF CONGRESS

Mr. Chairman, members of the Subcommittee, I am pleased to testify today on a proposal of the American Bar Association Joint Task Force on Security Interests in Intellectual Property labeled the "Federal Intellectual Property Security Act." While it is widely known that the Copyright Office has registered copyright claims since 1870, it is less commonly known that this Office has also recorded transfers of copyrighted materials from that date. Today, transfers of huge catalogs or libraries of copyrighted works occur frequently. Recordation of transfers—including security interests—is one of the core functions of the Copyright Office.

Our testimony today is based upon our expertise and experience in the administration of copyright law. We do not profess to be experts in the law or business of secured transactions. Nor would we presume to speak to the merits of the ABA proposal insofar as it may address needed reforms in the patent and trademark laws. In preparing for this hearing, we have consulted with representatives of various segments of the copyright community who have a stake in the system of recordation of transfers of interests in copyrights. We also recognize that lending institutions have an interest in a system that reliably and efficiently provides constructive notice of interests in copyrights, including security interests. We hope that today's hearing will represent the beginning of a dialog between those who believe that the framework of the current system is fundamentally sound—a view that we believe is shared by most copyright owners—and those who perceive a need for a system that better accommodates the requirements of their lending practices.

As I have suggested, it is the Copyright Office's understanding that some businesses producing copyrighted property and many financial institutions may support the ABA proposal. However, the Copyright Office also believes that the current recordation system, which requires the submission of actual documents and makes them part of the public record, is preferred by most copyright owners. Additionally, many prefer that constructive notice be limited to documents that specifically identify works and support the requirement that the work identified in the document be registered. I believe these are real strengths of the current system.

BACKGROUND TO COPYRIGHT RECORDATION

The current copyright recordation system had its origins in the first copyright statute assigning copyright responsibilities to the Librarian of Congress. In the Copyright Act of 1870,[1] section 89 [later recodified as section 4955] provided as follows:

> "That copyrights shall be assignable by law, by any instrument of writing, and such assignment shall be recorded in the Office of the librarian of Congress within sixty days after its execution, in default of which it shall be void as against any subsequent purchaser or mortgagee for valuable consideration, without notice."

Courts interpreting the provision ruled that the requirement of recordation was mandatory.[2]

[1] 16 Stat. 212; 41st Cong., 2d Sess., c. 230 sections 85–111 (1870).

[2] *Brady* v. *Reliance Motion Picture Corp.*, 229 Fed. 137 (2nd Cir. 1916)(interpreting the provision in the 1870 Copyright Act).

The 1909 Copyright Act enlarged the grace period but otherwise maintained the essence of the previous recordation system.[3] Section 44 [later recodified as section 30] provided as follows:

> "Every assignment of copyright shall be recorded in the copyright office within three calendar months after its execution in the United States or within six months after its execution without the limits of the United States, in default of which it shall be void as against any subsequent purchaser or mortgagee for a valuable consideration without notice, whose assignment has been duly recorded."

As with the 1870 Act, courts interpreted the recordation provision in the 1909 Act to be mandatory.[4] With respect to mortgages, the Second Circuit ruled in 1921 that copyrights can only be mortgaged under the federal copyright law.[5]

Based on our review of the background to the adoption of the general revision of the Copyright Act in 1976, it seems clear that Congress intended to create a federal system of copyrighted works which included a registry of claims to copyright and of transfers of copyright ownership. The 1961 Report of the Register of Copyrights on copyright law revision noted that although the previous law's requirement of recordation in the Copyright Office applied only to "assignments," it was not entirely clear under that law whether "assignments" included exclusive licenses or other transfers of less than all rights. The Report proposed that the law be clarified to state that other instruments, such as wills, trust indentures, decrees of distribution, mortgages and discharges, and corporate mergers should be considered transfers of copyright ownership. The Office recommended that the new statute specifically cover exclusive licenses and *all* other transfers of ownership. (Emphasis added).[6]

The Register stated that the purposes of a recordation system for copyright transfers were:

(1) to enable a transferee to give constructive notice to all third persons of the transfer of ownership to him; and

(2) to enable third persons to determine from the record who is the owner.[7]

These goals were also enumerated by Alan Latman in his study of the recordation system.[8] To meet these goals, the recordation system had to embrace all instruments by which the ownership of copyright is transferred in whole or in part. The Report of the Register stated that "records of copyright ownership are particularly important in view of the nature of copyright as a form of intangible and incorporeal property not capable of physical possession."[9]

With respect to what should be filed, the Office stated that there "should be practical assurance that the instrument recorded is precisely the same as the one executed."[10] Therefore, the Office recommended that the statute explicitly require that any instrument filed for recordation bear the actual signature of the person executing it or a sworn or official certification that it is a true copy. The Office stated that constructive notice should be confined to the facts specified in recorded instruments. Unrecorded documents could not get such effect. Moreover, the Office rejected blanket transfers. The Register's Report stated that "in some cases a recorded transfer will cover 'all the copyrights' owned by the transferor with no identification of the individual works," and concluded that constructive notice should be confined to copyright in works specifically identified by the recorded instrument. Otherwise, it might be "extremely difficult and time-consuming for a third person to ascertain whether the copyright in a particular work is covered by such a blanket transfer."[11]

The transfer provisions in the current law reflect the goals and recommendations of the Register. They were determined early in the revision process; the recordation

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[3] Act of March 4, 1909, ch. 320. section 44, 35 Stat. 1075, 60th Cong. 2d. Sess. (1909).

[4] *Photo-Drama Motion Picture Co.* v. *Social Uplift Film Corp.*, 213 Fed. 374 (S.D.N.Y.), aff'd, 220 Fed. 448 (2nd Cir. 1915).

[5] *In re Leslie-Judge Co.*, 272 Fed. 886 (2nd Cir. 1921).

[6] Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, House Committee Print, 87th Cong. 1st Sess. p. 94–95 (1961).

[7] *Id.*, p. 95.

[8] Alan Latman, The Recordation of Copyright Assignments and Licenses, Copyright Office Study No. 19, Committee Print, Subcomm. on Patents, Trademarks, and Copyrights, Senate Comm. on Judiciary, 86th Cong. 2d Sess. p. 119 (1960). The Latman study was one of 35 copyright law revision studies prepared for the Senate Subcommittee on Patents, Trademarks and Copyrights under the supervision of the Copyright Office.

[9] Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, House Committee Print, 87th Cong. 1st Sess. p. 95 (1961).

[10] *Id.* p. 96.

[11] *Id.*

provision of the first revision bill in 1964 was virtually identical to section 205 of the current law.[12] During the next twelve years (i.e., up to and including the passage of the Copyright Act of 1976), this section generated no controversy.

Today processing transfers of copyright ownership involves several steps. The original document that transfers copyright ownership which bears the actual signature of the person who executed it must be submitted for recordation; alternatively, a copy of the document may be submitted if it is accompanied by a sworn or official certification that it is a true copy of the original signed document. A Document Cover Sheet may be used to facilitate the cataloging process. Documents are verified, numbered, cataloged, and imaged for the public record. Certificates of recordation are issued; they bear the date of recordation and the volume and document number identifying the recorded document.[13] The original document is returned to the sender with the certificate. An online record is created of recorded documents which is searchable by parties and titles. In addition, registration numbers, if any, the nature of document, the date of execution and other bibliographic data appearing in the document are included in the online record. Processing time is currently about 6 months.

Before 1990, no question had been raised about the scope of the recordation provision. That changed with the decision of *In re Peregrine Entertainment Ltd.*, 116 B.R. 194 (C.D. Cal. 1990), which held that the only way to perfect a security interest in copyrighted works was to record the security interest with the U.S. Copyright Office. This was the intent of the drafters of the 1976 Act. However, after *Peregrine* some questioned whether section 205 of Title 17 was intended to be the sole method of perfection for security interests in copyrighted works. Moreover, the banking industry apparently believes the UCC filing system for security interests should play a prominent role in financing arrangements regarding copyrighted property.

The *Peregrine* decision was followed by two additional cases with similar holdings. *In re AEG Acquisition Corp.*, 127 B.R. 34 (Bank. C.D. Cal. 1991), *amended*, 161 B.R. 50 (9th Cir. BAP 1993); *In re Avalon Software, Inc.*, 209 B.R. 517 (Bank. D. Ariz. 1997). Recently, the United States Court of Appeals for the Ninth Circuit held in *Broadcast Music, Inc.* v. *Hirsch*, 104 F.3d 1163 (9th Cir. 1997), that an assignment to creditors of an interest in royalties from a copyrighted work is not a transfer of copyright ownership or a "document pertaining to a copyright" under section 205, and therefore need not be recorded with the Copyright Office. The Court distinguished *Peregrine* as a case involving a security interest in a copyright subject to recordation under section 205.

The *Peregrine* decision stimulated a study of the recordation system and a movement towards reform. The proposed Copyright Reform Act of 1993, H.R. 897, 103rd Cong. 1st Sess., would have permitted perfection of security interests by either a UCC filing or recordation with the Copyright Office. The bill also proposed other changes, such as the elimination of the requirement that the work be registered in order to be accorded constructive notice. Register of Copyrights Ralph Oman did not oppose reversing the *Peregrine* decision, but advised against making precipitous changes without adequate study.[14] The American Bar Association and other interested groups testified in favor of reform, but desired a more comprehensive reform incorporating a registry of security interests in all intellectual property including patents and trademarks.[15] The provisions were deleted from the proposed legislation in order to study whether a single system could be developed.[16]

THE ABA PROPOSAL

The ABA proposal would create a dual system permitting the perfection of security interests in federal intellectual property through a UCC filing at the state level or a filing of a new type of "federal financing statement" at the federal level. The proposed system would be radically different than the present system.

UCC filing systems are maintained by the Secretaries of State of the various states; under the ABA proposal, security interests filed at the state level would be

[12] H.R. 11947, 88th Cong. 2nd Sess., § 18; S. 3008, 88th Cong. 2nd Sess., § 18.

[13] 37 C.F.R. § 201.4(e) provldes, in pertinent part, "The date of recordation is the date when a proper document under paragraph (c) of this section and a proper fee under paragraph (d) of this section are all received in the Copyright Office."

[14] Copyright Reform Act of 1993: Hearings on H.R. 897 before the Subcomm. on Intellectual Property and Judicial Administration of the House Comm. of the Judiciary, 103rd Cong. 1st Sess. 232 (March 4, 1993) (Written Statement of Ralph Oman, Register of Copyrights).

[15] Copyright Reform Act of 1993: Hearings on H.R. 897 before the Subcomm. on Intellectual Property and Judicial Administration of the House Comm. of the Judiciary, 103rd Cong. 1st Sess. 160 (March 4, 1993) (Written Statement of J. Michael Cleary).

[16] H.R. Rep. No. 103-388, 103rd Cong. 1st Sess. 21 (1993).

filed in the state where the debtor lives. Alternatively, under section (b)(2)(B) of the proposal, holders of security interests in federal intellectual property would also have the option of filing a federal financing statement with the appropriate federal intellectual property agency. The federal financing statement, which would broadly describe the covered intellectual property rights, would encumber all copyrights owned by the debtor without specifying actual works. The proposal encourages the Copyright Office and the Patent and Trademark Office to create a system of joint administration; it does not mandate one unitary system. Priority between state filings and federal filings would be given to the first-to-file.

While the basic system for recording transfers of copyright under section 205 would remain the same, in two areas there would be important changes. First, the one-month grace period in section 205 would be eliminated in favor of a first to file system. Second, procedures for recording transfers secured through a default of a security interest would be substantially different from the requirements for recording other transfers.

CONCERNS OF THE COPYRIGHT OFFICE

In preparation for this hearing, we met with representatives of a number of copyright industries. They stated their preference for a continuation of the present system. We asked what the problem was that the ABA proposal was trying to address; they indicated it was after acquired property, *i.e.*, the needs of venture capitalists and the needs of start-up companies seeking investment capital. When we asked how they dealt with works that have yet to be created, a representative of a major motion picture company stated that periodic registrations are made for the work as it progresses (*e.g.*, registrations of various versions of a screenplay). We recognize that this may not be a solution for all of the copyright industries.

In our meeting, a number of concerns were expressed. One had to do with the proposal to have only a financing statement which might simply refer to intangibles and not include any specific titles. A second had to do with the fact that the actual document would not be on file in any public place. As our comments will indicate, we share these concerns. The copyright owners also expressed other concerns which I am sure they will bring to your attention.

We believe that most copyright owners oppose elimination of the exclusivity of the federal copyright system. At this point, it appears that for the sake of clarity and simplicity a federal system is better than coexisting federal and state systems. Clearly, the ABA's proposal represents a radical change in the recordation system. It deserves a full and deliberate study. Later in this testimony, I will mention a couple of ways in which the current system might be modified to accommodate the needs of lenders.

The Copyright Office has comments on a number of aspects of the ABA proposal, including: (1) changes in the section 205 system for recording copyright transfers other than security interests; (2) permitting perfection of security agreements without requiring specific identification of the works by titles or registration numbers; (3) making an exception, for security agreements, to the requirement that the actual document embodying the transfer of copyright be submitted for recordation; (4) the interplay between state UCC systems and the federal system; (5) the feasibility of and need for a joint administration of the system of recording security interests in federal intellectual property; and (6) administrative burdens posed by the proposed system. Our specific comments in these six areas are as follows:

1. Changes in the section 205 recordation system under the copyright law.

The ABA proposal would modify the section 205 recordation system in two areas. First, the one-month (two months for documents executed outside the United States) grace period in section 205(d) would be eliminated in favor of a first to file system. Second, procedures for recording transfers secured through a default of a security interest would be substantially different from the requirements for recording other transfers.

The current system giving priority to the first to execute, with a grace period for recordation, has been in place since 1870. The system provides that between two conflicting transfers, the first purchaser is protected as long as the transfer is recorded, in the manner required to give constructive notice, within one month of its execution in the United States or two months after its execution outside of the United States, or at any time before recordation in such manner of the later transfer. Otherwise, the later transfer prevails if it is recorded first in the manner to give constructive notice provided it was taken in good faith and without notice of the earlier transfer. The ABA proposes going to a first to record system. There are advantages to the ABA proposal. A system with a grace period means that a prospective purchaser cannot be completely certain that the silence of the record insures his protection. He cannot detect from the record an earlier purchase that has not been recorded; and the later recordation of the prior purchase will defeat him if takes place within one month after its execution.

On the other hand, the concept of an initial grace period is deeply rooted in U.S. copyright law. See Latman, Study No. 19 at 121. Latman notes that the drafters of the Uniform Conditional Sales Act in 1922 provided for a 10 day period during which a purchaser was protected against subsequent purchases even if he had not yet recorded; this was warranted by considerations of distance and unavoidable delays. Latman went on to note that such considerations were less persuasive in light of modern facilities for transmission of documents but that recordation in Washington, D.C. for transactions occurring throughout the United States might call for some grace period.

It is difficult to predict what the effect of abolition of a grace period would be. Despite tremendous advances in communication and transportation, a document executed today in Washington, D.C. can be submitted for recordation before a document executed yesterday in Moscow or even Los Angeles. The factors that justified a grace period in the 1870, 1909 and 1976 Acts may still be present today, although even proponents of the grace period cannot deny that the length of the period could be shortened considerably.

With respect to recordation of transfers secured through default of security agreements, section 3(b)(4)(G) would establish special procedures based on recording financing statements rather than the actual security agreements. Thus, for transfers of ownership that result from such defaults, the public record would be confined to a statement by the secured party identifying what was transferred as a result of the default. This would be in contrast to the public record for all other types of transfers, which would still require the recordation of the actual document of transfer. The result could be an impairment of the comprehensiveness and integrity of the public records of copyright ownership.

Moreover, the Office would have to establish different procedures with respect to records of transfer of ownership, depending upon whether the transfer was in exercise of a secured party's post-default rights or remedies. Administratively, it is difficult and burdensome to establish different procedures according to the type of document which is being recorded. We see no reason to abandon the current legal requirement that the actual document be submitted; in fact, we regard the requirement to be a strength of the current system. The Copyright Office therefore has serious concerns about the creation of a second category of procedures within section 205.

2. The perfection of security agreements not limited to specific titles of registered works.

Ideally, a public record of copyrighted works should permit title searches to ascertain who owns rights in a particular work, and the nature of those rights. That is the clear goal of the current system, which allows any document to be recorded, but gives constructive notice only to documents which specifically identify works by title or registration number. Recordation of transfers performs a vital informational function; titles of works covered by a transfer are extremely important and seem indispensable if the recording system is to be effective.

Under the ABA proposal, federal financing statements making general statements as to "intangibles" or "intellectual property" would cover all copyrights owned by the debtor. Since there is no requirement that federal financing statements identify the specific property which the statement covers, it would be impossible to ascertain through a search of the public record the works encumbered by the financing statement. As a result, clearing titles through a search of the public record could become impossible. Adding to the complexity would be the perfection of security interests in federal intellectual property which had been secured at the state level through UCC filing. We discuss this below.

3. The lack of recordation of the actual security agreement, which best defines the rights of the parties.

As mentioned above, the documents submitted for recordation are reproduced and maintained in the Copyright Imaging System. Before October, 1997, they were reproduced on microfilm. Retrieving documents is a central feature of the public record, enabling a determination of the precise language used by the parties in transferring, allocating or encumbering various rights. We believe there are clear advantages to a public record that provides public access to the very document that accomplishes a transfer of rights, rather than mere access to one party's characterization of the rights transferred to that party.

Under the ABA proposal, recordation of security agreements in either the federal system or the state UCC system would be accomplished by submission of a fairly simple financing statement completed by the financial institution. There is no requirement that the debtor sign the financing statement, and inaccuracies do not invalidate the filing "as long as such errors or omissions are not seriously misleading." The fact that the debtor would have no input to the filing of financing statements raises the possibility of abuse. Third parties interested in knowing what rights have been encumbered would find little useful information in the public record; there would be no means to gain access to the actual security agreement (and the language therein which states what rights are being encumbered) or to learn anything beyond the general description such as "intangibles" or "intellectual property." We recognize that there would be legal advantages for the financing institution to describe the encumbered property as broadly as possible, but we believe that those advantages would be outweighed by the disadvantages described above.

4. The interplay between state UCC systems and the federal system.

On previous occasions, the Copyright Office has not objected to proposals to overrule the *Peregrine* decision through statutory modification of the copyright law. This position was based on an assumption that this was what copyright owners as well as lenders wanted. However, after conferring with copyright owners we have concluded that there is no consensus that *Peregrine* should be overturned. Moreover, the ABA's proposed two-level system that would replace the current system seems unduly complicated.

Judge Kozinski noted in *Peregrine* 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. He wrote, "[t]o the extent there are competing recordation schemes, this lessens the utility of each. . . ."[17] He stated that "[i]t is for that reason that parallel recordation schemes for the same types of property are scarce as hen's teeth. . . . No useful purposes would be served—indeed much confusion would result—if creditors were permitted to perfect security interests by filing with either the Copyright Office or state offices."[18] He added, "if state methods of perfection were valid, a third party (such as a potential purchaser of 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. Because copyrights are incorporeal—they have no fixed situs—a number of state authorities would be relevant. Thus, interested third parties could never be entirely sure that all relevant jurisdictions have been searched." He found that such a system could hinder the purchase and sale of copyrights and frustrate Congress's policy that copyrights be readily transferable in commerce.[19]

We believe that Judge Kozinski made a compelling case for a single federal recording system for transfers of copyrights, including security interests. However, the single system need not necessarily be as comprehensive as suggested in *Peregrine*. We recognize at least two areas where there may be room for the filing of security interests with the states rather than with the Copyright Office: (1) security interests in receivables, and (2) recordation of security interests for purposes of constructive notice to other secured creditors, as distinguished from constructive notice to other assignees.

The Copyright Office agrees that the *Peregrine* decision, insofar as it relates to recordation of security interests in copyrights themselves, reflects the copyright law. Until *Peregrine*, there was no dissatisfaction of which we are aware with the recordation provisions of the law. We are aware that the banking community and some copyright owners believe that the *Peregrine* decision should be overturned, and we recognize that they are motivated by legitimate concerns. There may be gaps in the current system that should be addressed.

One controversial aspect of *Peregrine* is Judge Kozinski's conclusion that federal copyright law preempts state methods of perfecting security interests not only in copyrights, but also in related accounts receivable.[20] We do not believe section 205 necessarily requires that conclusion, and we do not believe that the policies underlying section 205's centralized recordation system necessarily require such a result. The Ninth Circuit may have undercut this aspect of the *Peregrine* ruling in *Hirsch*

[17] 116 B.R. 200
[18] *Id.*
[19] *Id.*
[20] *See, e.g.*, A. Haemmerli, "Insecurity Interests: Where Intellectual Property and Commercial Law Collide," 96 Colum. L. Rev. 1645, 1680 (1996); P. Choate, "Note & Comment: Belts, Suspenders, and the Perfection of Security Interests in Copyrights: the Undressing of the Contemporary Creditor," 31 Loy. L.A. L. Rev. 1415, 1430 n.95 (1998).

when it ruled that assignments of a right to receive royalties are not subject to section 205's recordation requirement. To the extent that financial institutions and their borrowers are concerned that their ability to engage in secured transactions is adversely affected by this aspect of *Peregrine*, it may be that the problem is relatively easy to resolve. A system that recognizes recordation of security interests in receivables at the state level likely would do no harm to the policies underlying section 205.

We also recognize that secured lenders desire to establish the priority of their liens vis-a-vis other lenders by resorting to the UCC system with which they are familiar. It may be that the considerations that led Congress to adopt a unitary filing system for copyright transfers do not require that the federal system be utilized for purposes of prioritizing rights of creditors among themselves. Thus, it may make sense to recognize perfection of security interests in copyrights at the state level for the limited purpose of allocating rights among lien creditors. On the other hand, it would do violence to the statutory scheme if a secured creditor who simply files a UCC–1 with a state secretary of state could obtain priority over a bona fide purchaser for value of all rights in a copyrighted work who has diligently searched the Copyright Office records and has discovered that those records reveal that the seller has clear title to the rights being sold. A secured creditor who wishes to secure his or her rights against the entire world, including those who have purchased all rights in a copyrighted work, should be required to use the centralized system established to provide constructive notice to the world.

5. The feasibility of joint administration of the system of recording security interests in federal intellectual property.

The major systems of federal intellectual property protection are copyright, patent, and trademark. The concepts and laws underlying these systems of protection are very different, and we believe administering these rights in the different agencies with specialized expertise enhances efficiency rather than inefficiency. Our other comments make clear that we view as strengths of the current system the requirement that the affected works be identified specifically and the requirement that the document of transfer be recorded and available for public inspection. These features may be irrelevant to the needs of the patent and trademark systems. We do not believe the case has been made for standardizing the system of recordation of security interests or other transfers in all federal intellectual property; therefore, we see no need or benefit from coordination of the various recordation systems.

6. Establishing a Totally New System of Recordation For Security Interests at the Federal Level

We have additional concerns about some of the details of the proposed new federal system for recording security interests which removes them from the system used for recording transfers of copyright ownership. We have already indicated some reasons why the proposed system based on federal financing statements seems inferior to the present system. The proposed system is also more complicated in many ways and would impose administrative burdens that do not seem warranted.

Under the ABA proposal, each filing statement would have to be date-stamped with the hour of filing. This is not currently done. Statements would lapse after 10 years unless a continuation statement is filed before the lapse. If the continuation statement is filed by someone other than the secured party of record, it must be accompanied by a separate assignment statement authenticated by the secured party of record. The system anticipates terminations and release statements as well as transfer statements.

Such a system would take time to develop and establish, require additional personnel and a new computer system. It would force all users to learn this potentially complicated new system. Additionally, a filing in the proposed new federal system may not prevail if there was first perfection at the state level. In short, the benefits of such a system appear to be outweighed by its burdens.

CONCLUSIONS

Records of copyright ownership are increasingly important in our global, networked society. The current recordation system has been in place since 1870. Enactment of the ABA proposal would change many of the established practices. The Copyright Office would not oppose any change on which a broad consensus has been achieved. However, the Office believes many of the proposed changes are controversial. Today's hearing serves a useful function as a starting point for discussion and debate about these issues. We caution, however, that any changes should be considered only after a careful study of the current system, of the needs of copyright owners, creditors and other users of the recordation system, and of the desirability and feasibility of changing the system that has for so long served the interests of the copyright community.

Mr. COBLE. We are joined by the gentleman from Indiana and the gentleman from California, Mr. Pease and Mr. Gallegly.

Ms. Peters, copyright owners have raised concerns that expanding section 110(2), would harm their markets both by interfering with opportunities and by increasing the risks of unauthorized dissemination over the Internet. In what way do your recommendations address these concerns?

Ms. PETERS. First, our recommendations are premised on the fact that in order to have the exemption, there must be both controls with respect to access to the work; and second, there must also be controls with respect to downstream uses. And the bottom line is if those protections are not in place, then the exemption cannot apply.

Mr. COBLE. In reference to filing of security interests with the Copyright Office, Ms. Peters, if you will, expand on why it is important that security interests be applicable to one work rather than applicable to all the works of an owner.

Ms. PETERS. One, for certainty. If you go back and you look at recordation statutes with respect to land, they record an interest that is very specific. You know where that piece of property is. If you go to the Constitution, you find that copyright is created in works, and it is a work that gets the protection and it is a work that has the bundle of rights and it is a work that has all transactions with respect to that work recorded in the Copyright Office.

In the 1976 act, there was a lot of study that went into it and one of the questions was whether or not you really needed to specifically identify the work. There was reference in the 1961 Register's Report about whether or not transfers that refer to all of the copyrights or all of the works owned by X was sufficient, and it was determined at that time by all of the people who were looking at this subject that you should have specific identification. So I think just as we need to specifically identify land, I think that the copyright owner's right is in a work or a series of works and they are identified by registration number or title, and I see no overriding reason why that should be turned on its head.

Mr. COBLE. Specificity, I guess, is the key word.

Ms. PETERS. Specifically identified some way.

Mr. COBLE. In your report, you recommend that Congress expand the categories of works covered by section 110 (2) to include audio-visual works. Why should audio-visual works be included under a new distance education exemption when they were not covered by the previous exemption for instructional broadcasting?

Ms. PETERS. I agree that that is the most controversial part of our recommendation. If you look at what was done in the 1976 act, it looked at whole works, so you can display any work; but when it comes to performance, you are limited to performing basically non-dramatic literary works and musical works. And the categories that are not covered are audio-visual works, pantomimes, dramatic works, and I think it was because it was felt that performing the entire work would seriously undercut the market for those works, including audio-visual works, and I think that the drafters of that statute believed that uses of portions of works could be covered by fair use.

In our hearings and in our conversations, what we heard was the most difficult issue was licensing of audio-visual works, not whole works, parts of works. And so when you deal with fair use, you are always dealing with uncertainty on whether you can or can't do something.

So, after much thought and much wrestling, we concluded that in today's educational world, all types of works should be allowed to be included under certain conditions as long as they don't interfere with the market for the work. And so we recommended including these additional types of works. But remember, we said only portions of works could be used and, again, it is only they can be used if the technological protection measures have been attached to them both with respect to gaining access to the work or making copies of that work.

Mr. COBLE. I thank you, Ms. Peters. The red light is now illuminating into my face and I will yield to the gentleman from California.

Mr. BERMAN. Thank you very much, Mr. Chairman. It is always a pleasure to have you with us and it seems like your analysis, both in your report and in your testimony is very good but I find a certain disconnect between the analysis and the recommendations.

You emphasize in your proposed changes that you got to mandate that the people who are utilizing those broadening exemptions have the appropriate protection to, one, limit access to the authorized; and secondly, to prevent the redistribution, retransmission, redissemination of these works. And then you say if the copyright protection technology were further along, further developed, broadening exemptions would be less dangerous to copyright owners, and if licensing were further involved, broadening exemptions could be less important for educators. Even though you have had these two "ifs," you conclude now is the time for legislation and solve the problem, I guess, by mandating the reasonable protection measures.

But if reasonable protection—either we have created—we haven't really broadened the exemption, because the reasonable protection measures aren't there and no one can take advantage of it, or we have applied "reasonable" in the sense of what is available now, which is pretty much well conceded is fairly ineffective, and therefore we have opened up the barn door, and I just——

Ms. PETERS. You could have been part of our discussions. We actually had these discussions for hours and hours and hours. And why we ended up concluding what we did really had to do with going back to the intent in 1976, which we have to really admit section 110(2) as it is cast is a broadcast exemption, it really doesn't cover works going through a computer, and that today computers are being used more and more and more in classrooms and in courses that are being offered by community colleges and universities. And we believed that if the intent that the legislators had in 1976 was intended to be there, then we should update it at least to allow the existing exemption. You can limit it to non-dramatic literary works in music to be updated, to include the transmission of those works through computer systems, as long as the additional concerns with regard to a digital environment are in place.

What that means, and maybe you will call it ducking the issue, is if they are not in place, you can't use the exemption; or, alternatively, if you are a legislator, you can say they are not in place so I am not going to put in an exemption. But the bottom line is still the same thing.

We recognize that there are huge dangers to copyright owners. We do believe that education is really important and that the fact that the exemption that was intended to cover then-existing technology is limited to broadcasting and doesn't cover computers is a problem today, so that is how we ended up where we ended up.

Mr. BERMAN. You are right in a way. You have got to acknowledge this new world. I don't know how the authors of the law in 1976—and some of them are around and some of them are in the room—they were better than I was if they could have anticipated this world then and made all the decisions they did make then, with all the different tradeoffs that exist now.

But what you are articulating is really an interesting kind of a proposal. We might change the legislation but may condition those changes on the implementation of a technology protection system that is not yet available; but then who decides and how is it decided when they are available? Is it after the fact, judicial determinations?

Ms. PETERS. One of the things you can consider is whether having that kind of a system in place would encourage more people to develop those types of systems, including educational institutions themselves.

Mr. BERMAN. You mean they are sort of drooling over the broadening of exemptions, and maybe they will get serious looking for a way to utilize them?

Ms. PETERS. Yeah.

Mr. BERMAN. Thank you very much, Mr. Chairman.

Mr. COBLE. Thank you very much, Mr. Berman.

The gentleman from Indiana.

Mr. PEASE. Thank you, Mr. Chairman.

Ms. Peters, we have spent a lot of time together on international issues here. That is one area—let me back up. I came in late, and if you have addressed this before I got here, I apologize; but I did not hear you address potential international implications of your proposals regarding either treaty or protocol obligations of the United States. Do you see any there?

Ms. PETERS. Actually, in this very long report, we did address international implications. We did point out the fact that article 13 of the TRIPs agreement puts limitations on the types of exceptions that you can have, and as well as Berne. However, exemptions that are narrow, that serve purposes like education, are allowed as long as, and it is very important, they don't interfere with the normal exploitation of the work and the markets that copyright owners have.

That is why on our recommendation, a proposal that if we were asked to draft it, it would include all of the technological protection measures. I think we were thinking that it would only apply to works that were not originally intended for the instructional market, because if you are in the instructional market, that is your normal licensing market. It is the television broadcasts that aren't really selling to schools and in fact don't really have an interest in licensing to schools, because the licensing may be more expensive than you would ever get out of any payment of any fee.

So it would be a very narrow exemption vis-a-vis the commercial exploitation of a work or the normal anticipation of a copyright owner with regard to gaining royalties or licensing fees from that market or that use.

Mr. PEASE. Does the construct that you are discussing, you were discussing with Mr. Berman, of legislation that is dependent upon technology that may or may not yet be available, does that concept present challenges in the international obligations of the United States? That concept, to my knowledge, is not yet acknowledged internationally.

Ms. PETERS. Countries that want to adhere to the new WIPO treaties must commit to putting in place remedies for acts or devices that basically take away the protection measures that have been put in place by copyright owners. And that is the only obligation, and they are doing that.

This is a little bit different. This is basically saying that in order for—our recommendation is in order for a university or an institution to be able to use a work without getting permission or without having a license, it would require that those protections be in place whether they are in place by the copyright owner or the university.

So it really is—the treaties and what we are talking about are a little bit different. The treaties have to do with remedies for copyright owners, for people who get around devices and protection schemes. This is basically saying in order to exploit a work, in order to use an exemption, those protections must be in place to make sure that the market that the copyright owner is entitled to is not undercut.

Mr. PEASE. Thank you very much. Thank you, Mr. Chairman.

Mr. COBLE. Thank you, Mr. Pease.

Ms. Peters, thank you for being with us. This dialogue will be ongoing, I am sure.

Ms. PETERS. I would be pleased to assist you in any way that we can.

Mr. BERMAN. The 14 other questions I had I think we can pursue in another forum. I think you are right, we have a large——

Mr. COBLE. We will move it along. We will be in touch, Ms. Peters.

I am now pleased to call the first big panel to the table and I will introduce them as they make their way to the table. Former Congresswoman Patricia Schroeder, who is President and Chief Executive Officer of the Association of American Publishers, the national trade organization of the U.S. Book publishing industry. Ms. Schroeder left Congress undefeated in 1996. She voluntarily left, in other words, after serving in the House of Representatives for 24 years. Mrs. Schroeder graduated from the University of Minnesota and went on to Harvard Law School, one of only 15 women in a class of more than 500 men. And, Pat, I will say to you and Howard and to Ed, if he is still here, someone asked me the other day if I had planned to retire after this session, and my response was "not voluntarily." We can be involuntarily retired in our business. Pat, it is real good to have you with us today.

Our next witness is another old friend whom I have not seen in recent days, Fritz Attaway, who is the Senior Vice President for Congressional Affairs and general counsel at the Motion Picture Association of America. Before joining the MPAA, Mr. Attaway served as attorney advisor in the Cable Television Bureau of the Federal Communications Commission. Mr. Attaway received his J.D. degree from the University of Chicago.

Our next witness is Laura Gasaway, who is the director of the law library and professor of law at the University of North Carolina; I am proud to claim, my alma matter. Good to have you with us, Ms. Gasaway. Ms. Gasaway is testifying on behalf of the Association of American Universities and has taught courses in intellectual property, cyberspace law, and law librarianship and legal resources. Ms. Gasaway received her B.A. From the Texas Women's University and her J.D. from the University of Houston. Ms. Gasaway, I am uninformed geographically. Where is the Texas Women's University located?

Ms. GASAWAY. It is in Denton, Texas.

Mr. COBLE. Thank you.

Our next witness is Mr. Glen Ochsenreiter who was recently named Vice President of Industry Relations at iCopyright.com. In 1994 Mr. Ochsenreiter became the Vice President of Marketing and Membership Services for the Software Publishers Association, now known as Software and Information Industry Association, and continued in that position through the beginning of this year.

Our final witness is a gentleman who I will let my old friend from Kentucky and also former member of this body introduce, Professor Cross. It is real good to have Ron back with us. Ron Mazzoli from Louisiana. Welcome back, Ron.

Mr. MAZZOLI. Thank you very much, Mr. Chairman. It is really great to join you in this historic room that saw so many of our discussions. I want to thank our colleague, Howard Berman, for his nice words about Representative Schroeder and myself, because in fact we all worked together on the immigration bill among others in our years here. And I join my friends, Mr. Jenkins and Mr. Pease, whom I have not served with, but to commend them.

It is my opportunity today, Mr. Chairman, to introduce my colleague. I am, as you know, with the University of Louisville. I had the great pleasure of working with Representative Schroeder when she came to Louisville as part of the Authors Forum to have a conversation, I would say, in front of several hundred people in Louisville about her book and to talk about many personal incidences we have had over these years.

But my real reason for being here is to introduce part of the panel, this distinguished panel, Professor John Cross who is my colleague at the University of Louisville School of Law, now the Louis D. Brandeis School of Law. Professor Cross graduated from Bradley University and got his J.D. From the University of Illinois, came to the University of Louisville in 1987 to the faculty. Prior to that he was practicing law in Minneapolis. His practice was then in a lot of different business fields, but included intellectual property.

Professor Cross focuses his research and his teaching in intellectual property and in authority of Federal courts. In 1991, Mr. Chairman, Professor Cross received a university award for his research, and in recent years has become active in international law issues conducting research at McGill University in Montreal and the University of Toronto at the request of the Canadian Government, and then taught at Johannes Gutenberg University in Maintz, Germany and also as a Fulbright scholar at the University of Turku in Finland.

I wanted to have this opportunity, and I appreciate the gentleman from North Carolina's extending it to me, to introduce Dr. Cross to the panel.

Mr. COBLE. Thank you, Ron. Good to have you back. Professor Cross, good to have with us.

We have written statements from all the witnesses on this panel and I ask unanimous consent to submit them into the record in their entirety.

Ladies and gentlemen, if you will, bear with me as I portray my role as grinch and remind you of that ever-present red light as it flashes before you. We will begin with Mrs. Schroeder.

STATEMENT OF PATRICIA SCHROEDER, PRESIDENT AND CEO, ASSOCIATION OF AMERICAN PUBLISHERS, INC.

Ms. SCHROEDER. Thank you very much, Mr. Chairman. It is indeed an honor to be in front of you and this distinguished panel. It is like a homecoming. But rather than trade stories with the light blinking, I guess I better get on with my work.

You so nicely described the Association of American Publishers, I don't think I need to go any further except to say we have educational publishers, trade publishers, scholarly publishers, university presses, nonprofit presses, for-profit presses and all sorts of others. So AAP represents most of the book publishing done in America.

Let me go on and say, too, we all want to thank you, Mr. Chairman, and this committee for what you did 8 months ago when the Digital Millennium Copyright Act passed. I think that was the biggest job's bill in this Congress and in the last Congress because both Bob Rubin and Chairman Greenspan say that the products of the mind, products where you add value with the mind, are really America's 21st century jobs. And you did a tremendous amount 8 months ago by working to apply intellectual property protection in the 21st century.

Part of the reason I am here is to say I really think what you did in giving the Register of Copyrights the right to take her staff and go through this whole issue about digital distance education was the right thing to do, and I think she and her staff did a fantastic job. It was very thorough and impartial. They toured America. They allowed many of our publishers to come forward and demonstrate many of the new digital education products that are coming out for distance education. We salute the terrific thorough job they did. Our only problem is we don't agree with the conclusion that we need legislation at this time.

I think it is too early for legislation until we see what is transpiring. Some of these areas have already been pointed out. You can take the report, and it talks about the fact that we do not have yet the technology for post-access protection. Terribly important, because people don't want to spend money creating these products and then lose them. I asked many of our publishers: Who are creating digital packages, how are you doing this? How are they creating distance education products that supposedly one can't do this without a change in the law? They said, "It is simple. We are either using our own works in the product, or we are using public domain works, licensing works from other people or we are employing fair use in different instances."

So everyone stipulates, including the report, there is a very robust, dynamic market in which all sorts of players are focussing all sorts of creativity. So the market isn't dysfunctional. There is also consensus with the study that we don't have the technology to protect products after they are produced.

Let me say there are several other things that we would question. That is, while the paper says on pages 152–3 that in 1976 when we wrote the Distance Education Act, most education was the province of nonprofit institutions, it goes on to say—today profit/nonprofit lines are all blurred. Profitmaking institutions are partnering with nonprofits, and there are all sorts of things going on.

We totally agree with the report's picture of the change going on in educational institutions today, so our question to you would be: Why would you change section 110(2) just for nonprofit organizations, because what does that mean today? What does that mean in today's world? It was much clearer in 1976, as they point out. So that is another reason we should pull back and let the market work.

The issue that is brought up on orphan works, again, we think that is important to deal with; but what we would say is the idea of orphan works cuts across to everything, not just distance learning. It cuts across course packs. It cuts across in all sorts of areas, not just digital and distance education. And finally we salute what the Register has done in clarifying and identifying many of the issues of confusion around the fair use doctrine.

And I think with this report out, many people will be able to focus back and use the knowledge and the gravidas of the Register of Copyrights to be able to try and sort some of fair use issues out. Working out these issues informally rather than starting to hammer it out in huge legislative agendas here on the Hill has always been the best way to proceed in such difficult areas of the law.

Basically AAP members has only been 8 months since we acted on the last legislation. We agree with the report that the market is robust and the post access technology isn't here yet.

And I see the red light is on, and I thank you again, Mr. Chairman, for letting me pack all this in.

Mr. COBLE. Thank you, Pat. Good to have you with us.

[The prepared statement of Ms. Schroeder follows:]

PREPARED STATEMENT OF PATRICIA SCHROEDER, PRESIDENT AND CEO, ASSOCIATION OF AMERICAN PUBLISHERS, INC.

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to appear here today on behalf of the Association of American Publishers ("AAP") to discuss the Register of Copyrights's "Report on

Copyright and Digital Distance Education," [1] which was submitted to Congress last month pursuant to Section 403 of the Digital Millennium Copyright Act ("DMCA"), P.L. 105–304.

As the principal national trade association of the U.S. book publishing industry, AAP represents more than 250 member companies and organizations that include most of the major commercial book publishers in the United States, as well as many small and non-profit publishers, university presses and scholarly societies.

AAP members publish hardcover and paperback books in every field, including general fiction and non-fiction, poetry, religion, children's books, and general and specialized reference works. In addition, AAP members publish scientific, medical, technical, professional and scholarly books and journals, as well as textbooks and other instructional and testing materials covering the entire range of elementary, secondary, postsecondary and professional educational needs. Apart from print publications, many AAP members publish computer programs, databases, and other electronic software for use in online, CD–ROM and other digital formats.

AAP'S INTEREST IN DIGITAL DISTANCE EDUCATION AND THE REGISTER'S REPORT

AAP members—and especially those whose primary markets come within the rubric of "educational publishing"—have important stakes in promoting the development of digital distance education opportunities consistent with the rights of copyright owners and users of copyrighted works under the Copyright Act.

To the extent that copyrighted works constitute a significant portion of the instructional materials used in distance education programs, AAP members have *dual* interests in related copyright exemption issues. While all AAP members—including trade book publishers and others not usually thought of as producers of "educational" materials—are creators or owners of preexisting copyrighted works that may be used by other distance education providers, many AAP members (particularly our nation's leading educational publishers) are themselves well-established providers of distance education programs which often feature the copyrighted works of others as well as their own. Moreover, many of these works and programs involve collaborative efforts with academic institutions and non-profit entities such as museums and public broadcasting stations.

AAP participated actively in the recent series of demonstrations, hearings and requests for comments that were initiated by the Register to create an evidentiary record on which to base the recommendations required by Section 403 of the DMCA regarding "how to promote distance education through digital technologies, including interactive digital networks, while maintaining an appropriate balance between the rights of copyright owners and the needs of users of copyrighted works."

AAP'S ASSESSMENT OF THE REGISTER'S REPORT AND RECOMMENDATIONS

AAP applauds the Register and her staff in the U.S. Copyright Office for doing an excellent job in conducting their study activities and crafting the Report. Given the obvious constraints imposed by the six-month statutory deadline for submitting the Report to Congress, the Register and her staff deserve recognition for conducting an extraordinarily thorough, open and impartial inquiry that offered ample opportunities for all interested parties to make their views and concerns known on a number of key issues regarding (1) the nature of distance education, (2) current related licensing practices, (3) the status of technological protections for the rights of copyright owners, (4) the application of current copyright law to digital distance education activities, and (5) prior attempts to address certain copyright issues through the negotiation of guidelines or the enactment of legislation.

The Report's summary and analysis sections, well-documented on the basis of the detailed record established through the Register's proceedings, provoke no serious disagreement or objection from the AAP. Unfortunately, the same cannot be said with respect to the Register's legislative recommendations.

THE REPORT'S MAIN RECOMMENDATIONS ARE AT ODDS WITH ITS KEY FINDINGS

AAP objects to the Register's recommendation for Congress to revise Sections 110(2) and 112 of the Copyright Act primarily because the call for such legislative action at the present time cannot be justified under the Register's stated test for

[1] Throughout this statement, we refer to "digital distance education" because that is the term used by the Register in her Report. However, AAP urges Congress to keep in mind that "distance education through digital technologies" and "education using digital technologies" are indistinguishable because campus-based education augments the classroom experience with e-mail, chat rooms, online content, and home-page syllabi, making it impossible to craft an exemption for one and not the other.

governmental intervention in the marketplace. In addition, the specific statutory recommendations at issue conflict with the Report's key observations regarding (1) the nature of today's distance education marketplace, and (2) the importance and status of technological measures against post-access infringing uses of copyrighted works.

Is government intervention through statutory revision necessary and appropriate at this time in the evolution of the digital distance education market? The Report points to a number of indications that today's marketplace for digital distance education is in a "state of flux" characterized by rapid and promising, but still evolving, developments which eventually will resolve whatever marketplace problems exist with respect to the use of preexisting copyrighted works of third-parties. (*See, e.g.*, p.57–68, 141–144). Accordingly, the Register acknowledges the critical importance of "timing" in considering whether current law should be changed (p.141, 144), and states that the test for determining when such government intervention would be justified is whether the markets in which distance educators participate are "dysfunctional" in a manner and to a degree that calls for a legislative remedy. (p.144, 164).

AAP believes that, notwithstanding the Register's recommendations, the Report's extensive observations regarding the state of the marketplace answer this question with a resounding "NO!" While program providers undoubtedly experience some problems in using some preexisting copyrighted works of others in connection with digital distance education, the marketplace clearly is not "dysfunctional" by any reasonable definition of that term. To the contrary, the Report specifically states:

- Distance education in the U.S. is "a vibrant and burgeoning field" which the advent of digital and other new technologies for delivery has made "the focus of great creativity and investment." (p.1)
- "[T]he expanded audiences for these programs represent a potentially lucrative market, which the varied participants in the process, including both corporations and educational institutions, are seeking to tap." (*Id.*)
- Notwithstanding some copyright issues, "digital technologies have fostered a rapid expansion in recent years, as well as a change in profile [in which] many more distance education courses are being offered than ever before, and the number is growing exponentially." (p.9)
- "Today's distance education courses use digital technology extensively for varied purposes and in varied ways. The addition of digital technologies to the distance education palette has produced new models of learning, resulting in a richer and more interactive class environment." (p.13)

When the issue is examined in terms of the use of copyrighted works in digital distance education delivered via interactive networks like the Internet, it is clear that the admittedly limited scope of Section 110(2) has not produced a "dysfunctional" marketplace. In fact, efficacy of Section 110(2) is simply irrelevant in the vast number of instances where providers of distance education through interactive digital networks create their own content, use public domain materials, obtain licenses to use the preexisting copyrighted works of others, or engage in "fair use" of third-party materials. (p.38)

In these circumstances, the Register's finding that "the technological characteristics of digital transmissions have rendered the language of section 110(2) inapplicable to the most advanced delivery method for systematic instruction" (p.144) does not—and cannot—rationally constitute a judgment that the marketplace for digital distance education is "dysfunctional." And, frankly, we are at a loss to explain the Register's apparent conclusion to the contrary.

But even if it were reasonable to reach such a conclusion in the face of the Report's other findings and thus justify the call for legislative action, the Register's proposed revision to Section 110(2) would still be substantively flawed in at least two fundamental respects that would skew public policy in direct contradiction to clear findings in the Report.

The first fundamental flaw in the Register's recommendations for revising Section 110(2) is that it is conditioned on the general availability of effective, convenient and affordable post-access technological controls on unauthorized uses to ensure that the revised exemption maintains a balance of interests between copyright owners and users of works that is "comparable" to the balance that Congress carefully crafted into the existing exemption when it was first enacted. (p.144)

It is hard to understand how the Register, while stating that the exemption's broadened coverage "should be tied to the ability to deploy such measures in addition to access control" (p.152), can urge Congress to move forward with the proposed revisions to Section 110(2) when the Report clearly states:

"Sophisticated technologies capable of protecting content against unauthorized post-access use are just now in development or coming to market, and may become widely available in the near future. But they are not there yet in a convenient and affordable form that can protect all varieties of works, and market uncertainties remain." (p.141)

AAP shares the Register's evident belief that effective, convenient and affordable technological measures will eventually become widely-available in the marketplace for digital distance education. However, in light of the Report's recognition that developments in technologies for protecting content "are harder to predict" than developments regarding licensing mechanisms and delivery systems for digital distance education (p.67), we see no sense in urging Congress to quickly enact a broadened exemption that will either be inapplicable to most digital distance education providers or improperly invoked by them, due to their inability to meet the essential condition precedent of having effective post-access technological controls "in place." (p.151)

Similarly, the second fundamental flaw in the Register's legislative recommendations is the arbitrary limitation of its application to non-profit educational institution. AAP can see no sense in statutorily revising Section 110(2) for the exclusive benefit of "nonprofit educational institutions" when the Report contains such unequivocal findings as the following:

"While mainstream education in 1976 was the province of nonprofit institutions, today the lines have blurred. Profit-making institutions are offering distance education; nonprofits are seeking to make a profit from their distance education programs; commercial entities are forming partnerships with nonprofits; and nonprofits and commercial ventures are increasingly offering competitive products." (p.152–153)

The Register appears to acknowledge that revising Section 110(2) to keep up with technological developments, but not with the evolving status of program providers, is untenable for public policy purposes; however, after a cursory review of several alternative options, the Report fails to address the concerns it cites for not pursuing other possible choices and simply falls back on the scope of its Congressional mandate to justify going forward with a revised exemption that would still be applicable only to nonprofit educational institutions. (p.153–154) Such a result cannot be squared with the realities of the distance education marketplace, where it would create unfair and unjustifiable inequities among providers of digital distance education programs.

Because the Register's Report generally depicts an active and growing—rather than "dysfunctional"—marketplace for the continuing evolution of digital distance education, AAP believes that Congress should be guided at this time by the Register's wise and practical observation that "a certain degree of growing pains may have to be tolerated if the government is not to step in prematurely, in order to give market mechanisms the chance to evolve in an acceptable direction." (p.143–144)

As the Register elsewhere recommended regarding the market for licensing non-exempted uses of copyrighted works (p.167), AAP urges Congress to give the market for digital distance education sufficient "leeway to evolve and mature" before determining that statutory intervention is necessary and appropriate.

THE REPORT'S OTHER RECOMMENDATIONS

AAP's rejection of the Register's recommendations for statutory revision does not mean that book publishers believe that nothing can or should be done at this time to constructively address some of the issues cited in the Register's Report.

For example, AAP believes that the Register has already performed an important public service in the Report by identifying *and* clarifying specific issues of "confusion and misunderstanding" regarding the "fair use" doctrine (p.161–162). Although the Register correctly concludes that authoritative clarification of these issues does not require statutory amendment to Section 107 of the Copyright Act, we believe the Report underestimates the value of the Register's own authoritative statements on such matters, in recommending further clarification through the legislative history to any statutory action Congress might take with regard to distance education.

AAP believes that the particular points of "confusion and misunderstanding" about fair use which are discussed in the Report are precisely the kind of matters that—in the absence of the need for corrective legislation—the Register can and should authoritatively clarify for copyright owners and users of copyrighted works. We are confident that broad dissemination of the Report and, more specifically, its comments regarding the technological neutrality of the fair use doctrine and the significance of fair use "guidelines" will accomplish the task of clarification without the need for dependence on the legislative forum.

With respect to the issue of "fair use" guidelines, AAP agrees with the Report's comments regarding the potential value of "additional discussion among the interested parties of fair use as applied to digital distance education." (p.162) AAP was a committed participant in the CONFU discussions that, as the Report states, "helped to further the parties' understanding of their respective interests and concerns." (*Id.*) Like other participants, we recognize that the CONFU process had certain shortcomings that contributed to its inability to fully achieve its goal of producing consensus voluntary guidelines. Since the Report has identified some of the attributes that might achieve greater success in such a forum, AAP would be happy to explore with the Subcommittee and the Register possible prospects for further CONFU-type deliberations.

Similarly, AAP believes it could be worthwhile to further explore the Register's discussion and recommendation regarding the issue of so-called "orphan works." The difficulties caused by the inability to identify rightsholders of certain works is a general problem for all users of copyrighted works, including book publishers. The obstacle this situation presents in the licensing context is not limited to distance education providers, but applies to all endeavors involving a person's desire to make certain uses of the copyrighted works of others when they cannot locate the rightsholder.

AAP cannot comment at this time on the Register's discussion of the Canadian law's "compulsory license" approach to the "orphan works" issue because at present we have little information regarding its operation.

However, once again, we would caution against prematurely seeking government intervention if there are non-statutory approaches to the problem that may be considered. AAP believes, for example, that copyright owners and their representatives may be able to utilize digital technologies and their own increasing presence on the Internet to foster new and better ways to make ownership and licensing information available online. Powerful new search engines and databases should present practical ways of helping users to more efficiently target their efforts to trace the ownership of rights in copyrighted works.

In any event, AAP believes that the problem of "orphan works" has broad impact across the whole spectrum of copyright and user interests, and we would be delighted to explore the issue further with the Subcommittee, the Register and other interested parties.

CONCLUSION

As documented in the Register's Report, the marketplace for digital distance education is a dynamic and expanding world of evolving experimentation, collaboration and innovation. Rapid technological change is producing revolutionary rethinking of business and academic models, related institutions, and the whole educational enterprise. While copyright and related licensing issues have created a few obstacles for participants to overcome, they have in no way created "dysfunctional" markets that deny digital distance education providers the opportunity to produce exciting new educational experiences for a broad range of students through digital technologies.

No stakeholder in digital distance education has reached a stage of last resort or a point of no return on the copyright matters at issue. There is ample time and reason to let the flexibility of the marketplace, with the inherent checks and balances of competition, work out continuing copyright issues without the intrusion of government mandates. At the same time, it is worth exploring other forums for additional ways to resolve problems.

It is barely eight months since the landmark DMCA was enacted by Congress and signed into law by the President. Until we all get a better feel for how technological protections and copyright management information will be deployed under the protections of the DMCA, Congress should stay its law-writing pen as it learns through real-world applications what it has already wrought with respect to copyright law in the digital environment.

At the present time, Congress does not need to further amend the Copyright Act to promote distance education. There are many other creative ways in which Congress may use its power to promote distance education if it chooses to do so.

Mr. COBLE. Mr. Attaway.

STATEMENT OF FRITZ ATTAWAY, SENIOR VICE PRESIDENT FOR CONGRESSIONAL AFFAIRS AND GENERAL COUNSEL, MOTION PICTURE ASSOCIATION OF AMERICA (MPAA)

Mr. ATTAWAY. Thank you, Mr. Chairman. Appearing here in place of Jack Valenti and then having to appear after Pat Schroeder puts pressure on me almost more than I can bear, but I will try this. I am also well aware of the 5-minute rule. Your counsel has advised me of that. In fact, she told me if I was a little shorter that would be nice too, so I will try to do that as well.

Mr. COBLE. She was taking undue liberty when she told you that. [Laughter.]

Mr. ATTAWAY. Thank you very much for allowing me to be here to present the views of the Motion Picture Association on these two very important issues.

MPAA commends the Register of Copyrights and her staff for the truly remarkable job that they did in preparing the Report on Digital Distance Education. They did it in the very short time frame provided by the Digital Millennium Copyright Act of 1998 and they did a thorough, thoughtful, illuminating, and insightful job.

We generally agree with the basic findings of the report which are well supported by oral and written statements and related information collected during the Register's short but meticulous investigation. Significantly, the Copyright Office did not find that current requirements for licensing copyrighted works for distance education uses, are materially slowing the development of distance education activities in this country. Although I would very much like to continue praising the Copyright Office report, I must now turn to matters of disagreement.

MPAA does not believe that the record developed through extensive written comments, hearing testimony, and demonstrations supports the recommendations for far-reaching legislative change contained in the report. Having found digital distance education activities in a state of early and dynamic development, and the technology not yet available that will make distance education uses safe for copyright owners, the Copyright Office nonetheless recommends some recalibration of the Copyright Act that at best may be unnecessary, and at worst could have a profound and adverse impact on copyright owners.

The possibilities of improper access and use, as the Office report points out, are manifestly magnified in the digital on-line environment, and has universally recognized the consequences in the digital environment of unauthorized reproduction, distribution, and modification of copyrighted works could be catastrophic. Yet the Office recommends that the use of audio-visual works be permitted in digital distance education in the face of findings that, quote, "Sophisticated technologies capable of protecting content against unauthorized post-access uses are just now in development or coming to market, although it is not clear when they will be widely available in a convenient and affordable forum that can protect all varieties of works."

Mr. Chairman, as a participant in two major negotiations aimed at setting forth fair use guidelines for the use of copyrighted material by educators, I can tell you without hesitation or qualification of any kind, that this is the way to go if existing practices need to be recalibrated to accommodate digital distance education activities. Face-to-face negotiations by men and women of goodwill and common purpose can produce dramatic results, offering welcome guidance for users and copyright owners alike. Moreover, guidelines can yield flexible results addressing emergent problems and addressing outcomes where necessary.

I urge you to consider that course if you find there is need for recalibration, and to establish a framework with appropriate congressional monitoring and oversight that will meet the educational needs of this country.

Turning now, if I may, to the issue of secured transactions, I have to tell you I am not an expert on the UCC or the law of secured transactions, but I have been advised by the experts in my industry that any changes in existing law are not necessary. On the general question of whether changes are needed in the present law governing security interests and intellectual property, our members see no urgent problem that needs to be fixed. In fact, we see no problem at all. The question that is presented is: Why? Who will benefit? Will any change facilitate the creation of copyrighted works? The current proposals will not benefit the producers that I represent, and if the present system works for creators and copyright owners, I would urge you to resist changing it.

Thank you very much.

Mr. COBLE. Thank you, Mr. Attaway.

[The prepared statement of Mr. Attaway follows:]

PREPARED STATEMENT OF FRITZ ATTAWAY, SENIOR VICE PRESIDENT FOR CONGRESSIONAL AFFAIRS AND GENERAL COUNSEL, MOTION PICTURE ASSOCIATION OF AMERICA (MPAA)

Mr. Chairman, members of the Committee, thank you for giving me this opportunity to express the views of MPAA on the Report of the Copyright Office on Copyright and Digital Distance Education, and on Intellectual Property Security Registration. MPAA member companies, which are among the world's largest owners and distributors of theatrical motion pictures, TV programs and home video material, have vital interests at stake with respect to both of these subjects.

REPORT OF THE U.S. COPYRIGHT OFFICE ON COPYRIGHT AND DIGITAL DISTANCE EDUCATION

MPAA commends the Register of Copyrights and her staff for the remarkable job they did in preparing this Report in the very short time frame provided by the Digital Millennium Copyright Act of 1998. The Report is thorough, thoughtful, illuminating and insightful. It provides an excellent starting point for the consideration of whether the Copyright Act should be amended to facilitate digital distance education.

MPAA participated at every stage of the process that led to this Report, and I am pleased to say that our views are fully and fairly represented, along with those of other interested parties. Moreover, we generally agree with the basic findings in the Report, which are well supported by oral and written statements and related information collected during the Register's short but meticulous investigation.

In particular, we fully concur with the findings that:

1. Digital distance education is in its nascent stage of development, but programs in existence are robust and thriving.
2. Digital distance education activities are growing rapidly.
3. Licensing mechanisms are developing to facilitate authorized use of copyrighted works in digital distance education activities.
4. Unauthorized access to, and reproduction and distribution of, copyrighted material used in digital distance education is a major concern that technology is being developed to address.

5. Although significant strides are being made, it remains to be seen when technologies necessary to prevent unauthorized access, reproduction and distribution will become widely deployed and available.

Significantly, the Copyright Office did not find that the current requirements for licensing copyrighted works for distance education uses is materially slowing the development of distance education activities. Of course, there are accounts that licenses could be easier to obtain and less costly, but such comments are not unique to educators. Most users of copyrighted material, including motion picture companies, frequently wish that they could obtain the right to use certain works that are not available for licensing or, in the eye of the user, over-priced.

Although I would very much like to continue praising the Copyright Office Report, I am at the point where I must turn to matters of disagreement. MPAA does not believe that the record developed through extensive written comments, hearing testimony and demonstrations of the vitality and range of distance education initiatives underway, supports the recommendations for far-reaching legislative change contained in the Report.

Having found digital distance education activities in a state of early and dynamic development, and the technology not yet available that will make digital distance education uses safe for copyright owners, the Copyright Office nonetheless recommends some "recalibration" of the Copyright Act that at best may be unnecessary, and at worst could have a profound, adverse impact on copyright owners.

As I view the Office's recommendations, it proposes that Sections 110(1) and 110(2) be collapsed with respect to digital distance education. That is, categories of works permitted for classroom use under Section 110(1) would be permitted for digital distance education purposes where their use would not be allowed (without the permission of the copyright owner) under Section 110(2) which addresses analog distance education activities.

This may not sound particularly radical, but it is. The performance of audiovisual works is permitted by Section 110(1) where use is confined to face-to-face teaching activities in a classroom or similar place devoted to instruction. In this environment, unauthorized access is tightly controlled, as is unauthorized use—in particular, the making and further dissemination of copies. Audiovisual works may not be used without permission under Section 110(2), where students are not all in one place; where access cannot be effectively controlled; and where improper uses cannot be effectively prevented.

The possibilities of improper access and use, as the Office's Report points out, are manifestly magnified in the digital on-line environment. And, as is universally recognized, the consequences in the digital environment of unauthorized reproduction, distribution and modification of copyrighted works could be catastrophic. Yet, the Office recommends that use of audiovisual works be permitted in digital distance education in the face of findings that "Sophisticated technologies capable of protecting content against unauthorized post-access use are just now in development or coming to market, although it is not clear when they will be widely available in a convenient and affordable form that can protect all varieties of works."

In fairness, I should point out that the Office's recommendations include the imposition of new safeguards aimed at counteracting the new risks, and, significantly, that use of audiovisual works be restricted to portions of works, but not entire works. However, the recommendations provide scant illumination of the structure and effectiveness of the "new safeguards," or of the definition of "portions."

As a participant in two major negotiations aimed at setting forth "fair use" guidelines for the use of copyrighted material by educators, I can tell you from personal experience that it is excruciatingly difficult to find the right words to delineate between what can be freely used and what requires permission, even when the parties are in total agreement on the concepts that should apply. But it can be, and has been, done.

After enactment of the 1976 Copyright Law Revision members of the educational and copyright communities negotiated guidelines for the off-air taping of broadcast programming for educational use. To my knowledge, these guidelines have been followed without complaint from either side for some 20 years now. More recently, in 1996, agreement was reached on guidelines governing the use of portions of works in educational multimedia productions.

As a participant in both of these successful negotiations, I can tell you without hesitation or qualification of any kind, this is the way to go if existing practices need to be "recalibrated" to accommodate digital distance education activities. The legislative process is, by its nature, public and often adversarial. Differences tend to be magnified and solidified in the heat of legislative battle by the need to take a firm public posture. By contrast, face-to-face negotiations by men and women of good will and common purpose can produce dramatic results capable of addressing issues in far greater detail, and offering welcome guidance for users and copyright owners alike. Moreover, guidelines can yield flexible results, addressing emergent problems and adjusting outcomes where necessary. If participants get it wrong, or circumstances change, problems can be fixed without having to undergo the rigors of the legislative process over and over again.

I urge you to consider that course if you find there is a need for "recalibration," and to establish a framework, with appropriate Congressional monitoring and oversight, that will meet the educational needs of our country. Indeed, under the auspices of the Patent and Trademark Office's Conference on Fair use, a significant amount of spade work has already been done with respect to proposed distance learning guidelines. If it does not work, you can always initiate a legislative process. But if you initiate a legislative process now, you may miss a golden opportunity to advance our educational objectives as well as provide necessary protection to copyright owners by the shortest, most efficient route.

INTELLECTUAL PROPERTY SECURITY REGISTRATION

Mr. Chairman, I must admit up front that I am not an expert in the Uniform Commerical Code or the law of secured transactions. I will do my best to relate the concerns expressed to me by experts in my industry. If I come up short, I trust you will permit me to supplement the record at a later time.

On the general question of whether changes are needed in the present law governing security interests in intellectual property, we do not believe the case has been made for change. Perhaps this hearing will reveal evidence to the contrary, but our members see no urgent problem that needs to be fixed. In fact, we see no problem at all. In our industry and in others with whose representatives I have discussed this proposal, creators of copyrighted works do not seem to be seeking changes in the current system because they cannot obtain financing. I would urge you, as a threshold matter, to make sure there is a real world problem that needs to be fixed before you spend your valuable time on complicated, and potentially disruptive changes in the law.

With respect to the proposal on security interests in intellectual property offered by the American Bar Association, we believe it creates serious problems for copyright owners as well as anyone wishing to acquire an interest in a copyrighted work.

Vague General Filing: The ABA proposal would eliminate Copyright Office recordation of security interests in specific copyrighted works and would only require filing of a general "federal financing statement" to perfect a security interest in intellectual property. The new federal financing statement under the ABA bill would not contain information sufficient to permit a party seeking to acquire a copyrighted work to determine whether that particular work was subject to a lien. Instead, the ABA bill would only require: (1) the name and address of the debtor and the secured party, and (2) a very general description of the collateral, such as "intellectual property" or "general intangibles."

Copyrighted works are frequently transferred on an individual or "catalogue" basis, and ensuring a clear chain of title for each particular work is critical. The current recordation practice facilitates these transactions. In fact, the Copyright Office records are often the only resource available to be "searched" for information pertaining to the initial ownership of, transer of rights in, and encumbrances on a copyright. The ABA proposal would significantly erode the utility of this important public record by allowing the following statement to satisfy the recordation requirement: "Party X has a security interest in all intellectual property now or hereafter owned by Party Y." The ABA proposal would place a substantial new burden on the purchasers of copyrights to confirm that a work is unencumbered.

Not only is the general filing requirement inappropriately vague, but the ABA proposal deems effective statements that contain errors or omissions, as long as any errors or omissions "are not seriously misleading." This loophole makes the federal financing statement essentially meaningless.

Coverage of Future Works: Under current law, security interests may only be recorded in the Copyright Office with respect to existing copyrighted works that are registered with the Copyright Office. The ABA proposal unwisely overturns this practice and would allow filing against future, as-yet-uncreated, unregistered copyrighted works. The leverage this would provide to lenders over authors and copyright owners is unacceptable. For example, under the ABA proposal, a small, recently established publishing company seeking a business loan may be forced to grant a security interest in later developed works without knowing which specific works are involved. Under current law, the disadvantage that a small company would have against a large financial institution is minimized because security interests will attach only to those works that are registered and that are specifically identified by the lender. The ABA would upset this balance and tilt the field in favor of financial institutions.

Funding Problems for New Filing System: The ABA proposes to create a new filing bureaucracy in the Copyright Office. The Copyright Office has already expressed its concerns over the large number of recordations of security interests and the expense of administering the existing system. The expense of creating and administering a new filing system would be even greater (particularly given the new ABA administrative requirements, such as renewal and continuation filings). Because most Copyright Office services are now user-fee supported, the new filing bureaucracy would impose a substantial economic burden on copyright owners that regularly use the registration, recordation and other services of the Copyright Office. The inevitable increased fees for copyright owners are not acceptable particularly when we view the vague filing as having little utility to our industries. Lender arguments about the burdens of "double-filing" are disingenuous. As anyone who has ever purchased a house or established a small business knows, financial institutions do not absorb administrative and filing costs—they pass them along to the borrower.

The more brief proposal put forth by the Commercial Finance Association is also of concern to us. The bill would overturn in part the decision in *In re Peregrine Entertainment Ltd.*, which focused on the importance of uniformity in a single filing system to providing adequate notice of encumbrances on copyrights, and held that the Copyright Act preempts state law regarding the manner of perfection of security interests in a copyright. Under the CFA proposal, it would be difficult, if not impossible, to determine whether there are encumbrances on copyrights. Again, our members are not troubled by existing law and practice—indeed they see substantial value in the current system—and do not seek legislative change.

The question "Why?" still looms large over any proposal to change existing law. Who will it benefit? Will it facilitate the creation of copyrighted works? The current proposals will not benefit the producers I represent. If other creators would benefit, we should hear from them. However, if the present system works for creators and copyright owners, I would urge you to resist changing it.

Again, I would like to thank you for giving me this opportunity to present the views of MPAA members. I look forward to responding to your questions.

Mr. COBLE. Ms. Gasaway.

STATEMENT OF LAURA GASAWAY, DIRECTOR OF THE LAW LIBRARY AND PROFESSOR OF LAW, UNIVERSITY OF NORTH CAROLINA, ON BEHALF OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

Ms. GASAWAY. Thank you, Mr. Chairman, members of committee. I am delighted to be here to represent the major higher education associations in support of legislation to amend the Copyright Act to update the exemptions for educational transmission.

As others on the panel have said, the Copyright Office did a marvelous job with its report and we believe that the recommendations contained in the report go a long way toward enabling institutions to move into the next century to utilize fully digital technologies without jeopardizing the market for copyrighted works.

We agree with Ms. Peters, Mr. Chairman, that the time is now to amend the Copyright Act for performance and display in distance education. Such an amendment serves the public interest in making education more accessible to all of our citizens.

Our education associations find themselves in the middle of this higher education debate, because we are certainly the initiators of many of the courses, but we are also the producers of much of the copyrighted material that is used. We have university presses that are a part of us as we approach these hearings, and indeed you have heard that many of the producers are calling for no amendment. On the other side, many of our constituents felt that we should go further than the existing statute and have more rights than we do in face-to-face teaching.

And so our associations came together and now have agreed on a proposal which very closely tracks what the Copyright Office has recommended. We have never asked for broad reproduction and distribution rights but only to amend section 110(2) to expand it to allow performance and displays of all types of works.

I might remind you that even though we are talking about digital technologies, much of distance ed is not digital today. It is still done with videoconferencing and other forms of technology. Why should a faculty member at UNC Greensboro, who teaches a course in live time in the classroom, be able to show a videotape, but when the course is offered over distance learning, the statute simply says you cannot do it without a license.

In 1976 we were looking at open broadcasts, like Sunrise Semester, where there were no controls on who was seeing that performance or display. Today we are talking about enrolled students only. We are talking about limiting that performance and display to a very small defined group. And even though the technology may not yet be here to protect downstream copying, it will be here soon, and I don't think there is any problem with putting that in the act, allowing the performance and display but requiring that the institution have some method to ensure no downstream copying. That simply might mean that those particular sessions have to be offered over videoconferencing today, that they cannot be offered digitally; but when those technological measures exist, then the digital performance should move along. It is counterintuitive to teachers to tell them you can show this videotape in face-to-face teaching, but not if you have any students who are at a remote location. It is simply counterintuitive.

We do question one recommendation by the Copyright Office, and that is that performance and displays for remote instructions should be limited to portion limitations. We believe that when the potential for infringement in a course offered remotely is no greater than the potential for infringement in a face-to-face course, then we don't see any reason for portion limitations. For example, the report argues that limiting performances to a portion of a work helps the potential market, since the public is interested in only the whole works. So if you have a portion, then the public is not interested. Well, if there are reasonable technological measures in place to prevent downstream copying and the courses are restricted to enrolled students, the public has no access to these works. It is limited to students in the class, and therefore portion limitations are not needed when you have these controls in place.

In conclusion, let me say that it is critical to our society that we have an educated populace. Education for the 21st century will be increasingly moving toward remote instruction. In the University of North Carolina system alone, we are projecting courses throughout the rural areas of the State. The goal of higher education is to have an exemption that promotes distance education through digital technologies and treats remote instruction as if it were face-to-face teaching.

The producer's goal, it seems to me, is to prevent unauthorized access to their works and downstream copying. We believe that the proposal, which is a compromise, takes care of both of these goals. It allows distance education to continue. It allows both asynchronous and synchronous education, but only when those technological measures are in place. We need an amendment now if distance education is to be a reality for our citizens.

Mr. COBLE. Ms. Gasaway, if you will, repeat what you said in your illustration about the professor at UNC Greensboro. I didn't follow you.

Ms. GASAWAY. But you picked up on the Greensboro, didn't you?

Right now under section 110(2), if a professor is teaching a class in a classroom, face to face, he or she may show a videotape to the students and the students can watch that tape. If there are any students located remotely, rather than in the classroom, then that videotape cannot be shown, because the types of works are limited to non-dramatic literary and musical works. Audio-visual works are currently excluded, so there could be a way to prevent downstream copying by saying you have to have a staff member in that classroom remotely. But right now that doesn't do it, so we need an amendment right now, Mr. Chair.

Mr. COBLE. Thank you very much, Ms. Gasaway.

[The prepared statement of Ms. Gasaway follows:]

PREPARED STATEMENT OF LAURA GASAWAY, DIRECTOR OF THE LAW LIBRARY AND PROFESSOR OF LAW, UNIVERSITY OF NORTH CAROLINA, ON BEHALF OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

I am Laura Gasaway, Director of the Law Library and Professor of Law at the University of North Carolina at Chapel Hill. I appreciate the opportunity to testify before you today on behalf of the undersigned higher education associations in support of legislation that would update the existing exemption for educational transmissions in the 1976 Copyright Act. I was also privileged to represent these organizations in testimony at a hearing last January before the Copyright Office. That hearing was part of the comprehensive study mandated by this Congress when it passed the Digital Millenium Copyright Act, resulting in the recommendations we are considering today.

Before I comment on any of the specific recommendations contained in the Copyright Office's report, I would like to commend the Copyright Office staff for the fair and balanced way in which they conceived and carried out their mandate. The depth and breadth of information contained in the report reflects the seriousness and thoroughness with which they conducted this study. We believe that the report's recommendations reflect the care and thoroughness put into their study, and represents a thoughtful effort. This set of recommendations goes a long way toward enabling educational institutions to fully utilize digital technologies without jeopardizing the market value of copyrighted works.

Mr. Chairman, I have attached to my testimony today a copy of my statement and written comments subsequently submitted by higher education associations to the Copyright Office during the course of its study of the issues. Together these documents describe the terms for an exemption we believe will allow distance education to fully utilize the potential of the digital environment in a manner that protects the interests of copyright owners. We continue to believe that the basic objective of a distance education legislative exemption should be to enable remotely all instructional activities that are currently permitted in the classroom, provided that adequate safeguards exist against the misuse of copyrighted material that would harm the market for that material. I do not plan to use my time here today to reiterate the proposal that we submitted to the Copyright Office. However, please feel free to ask me any questions you may have about it, and I will be happy to respond either orally or in writing.

As you will note, a large number of national educational organizations endorsed the proposal these organizations I represent today developed. However, some of our colleagues within education circles felt then and continue to feel that our proposal falls short of the exemption necessary to promote distance education. Nevertheless, we understand the need for compromise on a difficult issue such as this.

With that in mind, we believe the Copyright Office recommendations generally represent a balanced, reasonable approach that we strongly support. In my statement today I plan to address only three or four major recommendations, but I hope that we will be allowed to expand on our statement at a later date.

First, let me say that we heartily endorse a great number of the Copyright Office recommendations without reservation. For instance, the Copyright Office would eliminate the provision in 17 U.S.C. §110(2) requiring exempted displays and performances to be transmitted to a classroom or similar place of instruction. Eliminating the classroom requirement is critical to enabling distance education programs to reach students where they are, and to fully utilize the vast potential of distance education to benefit the public. We encourage the Subcommittee to incorporate recommendations such as this one into legislation. Without these provisions, distance education programs would continue to be unnecessarily curtailed.

We likewise support the Copyright Office recommendation that distance education programs should be exempt for whatever reproductions and distributions are technologically necessary to digitally transmit a display or performance over computer networks. We also agree that the purpose in extending the exemption to incidental reproductions and distributions should be only to permit exempted displays and performances to be viewed by the remote student. Based on our understanding of the Copyright Office recommendations, we believe that the proposed amendments to 17 U.S.C. §110(2) allowing transient copies and to §112 allowing ephemeral copies to be posted to a server would be sufficient to accomplish this goal.

We believe that, together, these proposed amendments would permit access to course materials at times selected by the student. In order, however, to ensure that the statutory language is not limited to current technology, we would ask Congress to clarify its intent that the exemption would be available to both synchronous and asynchronous transmissions. Anything less would severely limit the development of and potential benefits from the use of digital technologies in distance education.

Second, as we clearly indicated in our proposal to the Copyright Office, we agree with the recommendation that reasonable technological safeguards against downstream copying and distribution must accompany any expansion of the distance education exemption to digital transmissions. Consistent with the recommendations, we explicitly supported a requirement that access to materials must be limited to bona fide students enrolled in the course, as well as the adoption of policies and procedures that promote compliance with copyright laws. We agree with the Copyright Office that an exemption should not become a substitute for student purchase of course materials.

However, we question the Copyright Office recommendation that, in addition to reasonable technological protections against unauthorized uses of copyrighted materials, there is a further need to limit the portion of a work that may be transmitted to students. Where the potential for infringement is no greater remotely than in a local classroom, we see no reason, for instance, why a professor in a supervised, video teleconferencing situation should not be able to display or perform whatever he or she could in a classroom setting.

The Copyright Office argues that limiting a performance to a portion of a work helps protect the market for that work, since the public would have no interest in less than the whole work. However, this argument is not relevant because, when there are technological measures to prevent downstream copying, the public does not have access to the work. Rather, it applies only where the public has access to the work because safeguards against unauthorized copying and distribution are not in place. As we suggested to the Copyright Office, a limited exemption, such as one that limits the portion of works that may be performed, should be available to distance education programs that limit access to the course and implement strategies to promote compliance with copyright law, but are unable to employ technologies to prevent downstream use of materials.

Finally, there are a number of recommendations contained in the report that we would be pleased to support with further clarification regarding their intended effect. For instance, the report recommends that the law should impose an obligation on educational institutions not to interfere with technological protections copyright owners may apply to their works. This provision is apparently adapted from the Digital Millennium Copyright Act exempting internet service providers from liability for infringing acts by a subscriber. It is not obvious how a similar requirement would work as a practical matter in the context of distance education. An ISP serves as a passive conduit for materials uploaded by others, whereas in distance education the works are uploaded by the educational institution. It would appear that the distance education exemption could be nullified by copyright owners whenever protections applied by them would prevent legally acquired works from being uploaded in the first place. In these circumstances educational institutions would lose the distance education exemption and be reduced to having access to material only on terms chosen by the copyright owner by a license. We would hope that Congress will clarify that, by prohibiting interference with protections applied by a copyright owner, it does not intend to prevent the transient and ephemeral copies or the transmission and reception of exempt displays or performances.

Congress clearly recognized the import and complexity of a copyright exemption for digital distance education when it charged the Copyright Office with responsibility for conducting the study and making the recommendations you now have before you. This issue is of vital concern to the educational institutions we represent. The higher education associations have been pleased to participate in the process created by the Copyright Office.

We agree with the Copyright Office characterization of their recommendations as extending the policy enacted by Congress in 1976 into the digital environment of today and the future. We believe the Copyright Office recommendations represent a balanced, reasonable approach and we endorse a great number of the recommendations without question. We urge Congress to adopt these recommendations by making the necessary changes to current law. In doing so, we hope you will give careful consideration to our modest suggestions for modifications to, or clarification of, those recommendations.

Thank you for the opportunity to present our views.

On behalf of:

American Association of Community Colleges
American Associations of State Colleges and Universities
American Council on Education
Association of American Universities
Association of Research Libraries
EDUCAUSE
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges

[*Note:* Additional material submitted by Ms. Gasaway is on file with the House Judiciary Committee's Subcommittee on Courts and Intellectual Property.]

Mr. COBLE. Mr. Ochsenreiter.

STATEMENT OF GLENN OCHSENREITER, VICE PRESIDENT, INDUSTRY RELATIONS, iCOPYRIGHT.COM

Mr. OCHSENREITER. Mr. Chairman and members of the committee, on behalf of iCopyright.com, I would like to express our appreciation for the invitation to testify this afternoon. I hope our perspective is useful as you consider the U.S. Copyright Office recommendations on copyright and digital distance.

As we are all aware, technology is creating exciting new educational opportunities for students and teachers both in schools and beyond traditional school boundaries. The same technology, however, creates new challenges for schools and copyright owners because of the unique elements presented by digital transmission display.

I am here on behalf of iCopyright.com to testify that new technology is coming on-line that will help overcome these obstacles. iCopyright.com is a privately funded Internet start-up that is launching this fall the first comprehensive automated copyright permissions and reprints clearinghouse. It is a non-punitive system that respects both the culture of the web and the value of intellectual property.

This Web-based clearinghouse will greatly simplify the process of obtaining a license to reuse copyrighted material. It covers not only traditional uses such as photocopying and reprints, but a broad range of new electronic reuse opportunities as well, such as electronic reprints or e-prints as we call them, and the distribution of copyrighted material through e-mail. Our service encourages users to do the right thing by making it convenient to do so. There is no fee for content owners to register their material or for users to review licensing terms and be put in contact with the publisher.

The service is currently in a pilot program with a number of leading publishers that represent traditional media as well as original Web content, including Barrons on-line, COMTEXT, Newsweek interactive, PricewaterhouseCoopers, Wall Street Journal Interactive edition, and Washingtonpost.com.

iCopyright enables content owners and users to find each other easily and provides the automated processing infrastructure to immediately execute licensing transactions for the benefit of both parties. As a true clearinghouse, iCopyright is independent of publishers, corporate customers, academic institutions, and any particular encryption or payment technology. As such, iCopyright does not choose sides of how to lobby an agenda with respect to the challenging issues of copyright, exemptions to copyright, and fair use. We are, however, in a position to testify that the benefits of technologies like ours will soon transform the copyright permission process itself from a cumbersome and extended undertaking that frequently produces no results into a streamlined, efficient operation providing enhanced benefits for intellectual property licensees and licensors.

As described in the Copyright Office Report, many educational institutions that would like to license material for digital distance education have reported a number of difficulties. First, in locating copyright owners; second, in obtaining the timely response from the copyright owner, once located; and third, in meeting the terms set by the copyright owner. We believe iCopyright's automated permissions clearinghouse will have a positive impact on all these problem areas.

Publishers can easily register their content with iCopyright and list the types of clearances they are willing to license. Users interested in obtaining a license can quickly review available clearances. This can be as easy as clicking on the iCopyright logo at the bottom of a Web document. This service at no cost to either party will reduce from months to moments the time it takes to locate the copyright holder and learn what clearances are available.

In addition, we believe most content owners will choose to offer instant clearances through iCopyright's patent pending Web-based transaction engine which automates the clearance process, collects and distributes licensing royalties, and delivers the content in the desired format, with proof of clearance.

Licensing terms and all decisions about the types of clearances offered through iCopyright are determined entirely by content owners. We believe, however, that the transition to real-time clearance transactions via the Internet will strongly influence and encourage the simplification of these terms and the moderation of license fees. Because the automation of clearance transactions removes most of the overhead associated with licensing, publishers are likely to offer a range of clearances that they would not economically justify in the past.

Most importantly, access to real-time information about prices leads to a more efficient marketplace, a marketplace where the price you pay reflects actual demand. On-line auctions are a prime example of this. Pricing will tend to find its way to a point that is low enough to motivate institutions to obtain rights for the reuse of coveted material and avoid possible liability for unauthorized use but high enough to create meaningful new revenue for content owners.

iCopyright applauds the Copyright Office's fundamental premise that emerging markets should be permitted to develop with minimal government regulation and that copyright owners and users should have the opportunity to establish mutually satisfying relationships as new technology leads to the development of new markets for copyrighted works.

We are confident that the frictionless efficiency and immediacy of automated Web-based copyright clearance transactions will provide the foundation for effective market mechanisms to quickly take hold without the requirement of adjustments to existing law.

Thank you again for the opportunity to testify today and I look forward to any questions that may be raised by my testimony.

Mr. JENKINS [Presiding]. Thank you, sir.

[The prepared statement of Mr. Ochsenreiter follows:]

PREPARED STATEMENT OF GLENN OCHSENREITER, VICE PRESIDENT, INDUSTRY RELATIONS, ICOPYRIGHT.COM

As we are all aware, technology is creating exciting new educational opportunities for students and teachers both in schools and beyond traditional school boundaries. This same technology, however, creates new challenges for schools and copyright owners because of the unique elements represented by digital transmission and display. I am here on behalf of iCopyright to testify that new technology is coming online that will help overcome these obstacles.

iCopyright is a privately funded Internet start-up that is launching the first comprehensive, automated copyright permissions and reprints clearinghouse this fall. It is a non-punitive system that respects both the culture of the Web and the value of intellectual property. This Web-based clearinghouse will greatly simplify the process of obtaining a license to reuse copyrighted material. It covers not only traditional reuses such as photocopying and reprints but a broad range of new electronic reuse opportunities as well, such as electronic reprints, or "e-prints," and the distribution of copyrighted material through e-mail. Our service encourages users to do the right thing by making it convenient to do so.

There is no fee for content owners to register their material or for users to review licensing terms and be put in contact with the publisher. The service is currently in a pilot program with a number of leading publishers that represent traditional media as well as original Web content, including Barron's Online, COMTEX, Newsweek Interactive, PricewaterhouseCoopers, Wall Street Journal Interactive and Washingtonpost.com.

iCopyright enables content owners and users to find each other easily and provides the automated processing infrastructure to immediately execute licensing transactions for the benefit of both parties. As a true clearinghouse, iCopyright is independent of publishers, corporate customers, academic institutions and any particular encryption or payment technology. As such, iCopyright does not choose sides or have a lobbying agenda with respect to the challenging issues of copyright, exemptions to copyright and fair use. We are, however, in a position to testify that the benefits of technologies like ours will soon transform the copyright permission process itself from a cumbersome and extended undertaking that frequently produces no results into a streamlined, efficient operation providing enhanced benefits for intellectual property licensees and licensors.

At iCopyright, we are convinced that most corporations and institutional users want to do the right thing in properly licensing the reuse of content—they are often creators and owners of intellectual property in their own right. It should be noted as well that although our service is based on the honor system, our digital tools do allow for self-policing by publishers and regulatory agencies that are seeking to locate unauthorized reuses of content that has been registered with iCopyright.

As described in the Copyright Office report, many educational institutions that would like to license material for digital distance education have reported a number of difficulties: first, in locating copyright owners; second, in obtaining a timely response from the copyright owner once located; and third, in meeting the terms set by the copyright owner. We believe iCopyright's automated permissions clearinghouse will produce a positive impact in all of these problem areas.

Publishers can easily register their content with iCopyright and list the types of clearances they are willing to license. Users interested in obtaining a license can quickly review available clearances—this can be as easy as clicking on the iCopyright logo at the bottom of a Web document. This service, at no cost to either party, will reduce from months to moments the time it takes to locate the copyright holder and learn what clearances are available. In addition, we believe most content owners will choose to offer instant clearances through iCopyright's patent-pending Web-based transaction engine which automates the clearance process, collects and distributes licensing royalties, and delivers the content in the desired format with proof of clearance.

Licensing terms and all decisions about the types of clearances offered through iCopyright are determined entirely by content owners. We believe, however, that the transition to real-time clearance transactions via the Internet will strongly influence and encourage the simplification of these terms and the moderation of license fees.

The automation of clearance transactions removes most of the overhead expense previously incurred by publishers. Lower overhead encourages publishers to offer a range of clearances that they could not economically justify in the past. Because of the opportunity to expand the number of clearances provided, lower overhead also encourages lower prices on previously available clearances. In addition, through iCopyright, content owners can more easily provide licenses at no cost for certain uses or for particular classes of users, such as non-profits, academics or for personal use. Because the process is immediate and easy, publishers will find demand increasing because more users can find their clearance offerings and complete the transaction.

Most importantly, access to real-time information about prices leads to a more efficient marketplace where the price you pay reflects actual demand. Online auctions are a prime example of this. Pricing will tend to find its way to a point that is low enough to motivate institutions to obtain rights for the reuse of coveted material and avoid possible liability for unauthorized use, but high enough to create meaningful new revenue for content owners.

iCopyright applauds the Copyright Office's fundamental premise that emerging markets should be permitted to develop with minimal government regulation, and that copyright owners and users should have the opportunity to establish mutually satisfying relationships as new technology leads to the development of new markets for copyrighted works. We are confident that the frictionless efficiency and immediacy of automated Web-based copyright clearance transactions will provide the foundation for effective market mechanisms to quickly take hold without the requirement of adjustments to existing law.

Mr. JENKINS. Professor Cross.

STATEMENT OF JOHN CROSS, PROFESSOR OF LAW, UNIVERSITY OF LOUISVILLE SCHOOL OF LAW

Mr. CROSS. Thank you. I would like to thank the subcommittee for the opportunity to speak today. I would like to thank Representative Mazzoli for his kind words of introduction.

My written statement actually deals with both of the matters on the agenda, but because of the makeup of this panel, I thought I would confine my oral testimony to the Copyright Office proposal.

Let me say at the outset that I have experience on both sides of the issue of digital distance education. While in practice, a number of my clients were intellectual property owners and my work was to protect their interests.

Now I am an educator and I have seen that distance education, although I was a skeptic at first, does hold out a number of advantages. It does hold out a number of advantages especially to the so-called non-traditional student.

Like everyone else on the panel, I would like to commend the Copyright Office for an excellent report. I have no quibbles or qualms whatsoever with the background material. I really have nothing to add to that background. My discussion is going to focus, like everyone else, on the proposals for legislative change that were set out in that report. I think my views correspond quite closely to those of Professor Gasaway.

The proposal does make a number of excellent suggestions for changes to section 110(2), the exception that deals with educational transmissions. Because of changes in technology, those proposed amendments are crucial if digital distance education is truly going to work. The goal, as I see it, though, is not simply to make distance education work, but to maximize its use in order to reap the benefits to non-traditional students. If we are going to do that, if we are truly going to maximize the use of digital distance education, then I would suggest the Copyright Office Report's proposals don't go far enough.

Currently the Copyright Act has two separate exceptions that deal with educational use. Section 110(2) we have discussed at length. There is also section 110(1), the face-to-face in-class section. If we are going to encourage the use of distance education, why not make the two into one? Why not merge section 2 into section 1, thereby abolishing all of the additional limitations on digital distance education? The greatest impact as we have discussed so far would be on things like audio-visual works. Audio-visual works cannot currently be shown by distance education. They can be shown in the classroom.

That would, or could at least, create problems. I think the fear is we are going to have some sort of pirate industry of students downloading vast quantities of material and distributing them in some sort of underground market. I admit that could be a real fear.

I would suggest, though, that the Copyright Office proposal provides a way to control that, and again I will return to the question of technology. The proposed changes to section 110(2) recommend the use of technological controls to limit the distance education process. These technological controls really touch on three points. First, they limit student access. They limit access to students enrolled in the class. Second, you limit the students basically to a single opportunity to view the work. Third, you would limit the ability to download works and to make copies for others.

If the act is amended to add those restrictions, what real difference is there between distance education and the section 110(1) classroom experience? The fundamental idea underlying the section 110(1) exception is that the student sees the work once and really has no opportunity to make a real copy. If we can add technological restrictions that limit distance education students in the same way, why should we treat the two situations any differently?

As long as an educator and an educational institution make a reasonable effort to use available technological controls, then I suggest the two ought to be treated equally. Both ought to be able to show exactly the same sorts of works in their entirety.

In closing, I would like to emphasize the Constitution itself tells us why we have copyright. The purpose of copyright is to promote the progress of science. Science in the Constitution means knowledge, and while I agree that it is crucial to provide an incentive to artists, musicians, and authors to produce that knowledge, we can't forget that it is also important to ensure that that knowledge reaches its intended beneficiaries. We need to have amendments to the Copyright Act that allow distance education to reach its full potential.

I would like to thank the subcommittee for the opportunity to speak. I would be willing to answer questions not only on the Copyright Act proposal but perhaps as part of the second panel regarding security interest proposal. Thank you.

Mr. COBLE. Thank you, Professor.

[The prepared statement of Mr. Cross follows:]

PREPARED STATEMENT OF JOHN CROSS, PROFESSOR OF LAW, UNIVERSITY OF LOUISVILLE SCHOOL OF LAW

SUMMARY

Both of the items on today's agenda deal with important issues that have arisen in the realm of intellectual property. Although the proposals contained in each document are essentially sound, both could benefit from a few minor changes.

Report on Copyright and Digital Distance Education

This comprehensive report does an admirable job setting out the many copyright problems that have arisen in the use of new digital technologies for distance education. I fully agree with the overwhelming majority of the Report, especially the background materials. My few comments relate solely to the suggestions for legislative change contained in the report. In short, I:

- Generally agree with most specific proposals set out in the Report. The antiquated language of the § 110 exceptions should be updated to enable the effective use of modern digital technology in distance education.
- Disagree with the proposal that teachers involved in distance education should not have the same freedom to use copyrighted works as teachers in the classroom.
- Suggest that rather than amending § 110(2), Congress should merge that exception into the "face-to-face" education exception in § 110(1). This more sweeping change would put distance education on an equal footing with classroom education insofar as the unlicensed use of copyrighted works is concerned. The greater risks posed by distance education could be dealt with by technological controls.

Federal Intellectual Property Security Act

This proposal for legislation seeks to remedy flaws in the filing systems maintained by various federal offices for security interests in intellectual property. Although the proposal is well thought-out and carefully crafted, it could be improved in several ways, including:

- Excluding marks from the provision requiring the filing of a federal financing statement. Because of several crucial differences between federal marks and other forms of federal intellectual property, the proposal would result in a de facto "dual-filing" system for marks. In addition to being redundant, this dual-filing system poses some risk to lenders and consumers.
- Revising the key provision to make it clear that filing a federal financing statement gives the lender priority not only over subsequent transferees, but also over junior secured lenders.

STATEMENT

Mr. Chairman and the Members of the Subcommittee:

My name is John Cross. I am a Professor of Law at the University of Louisville School of Law in Louisville, Kentucky. Before I begin, I would like to thank the Subcommittee for the opportunity to address the two items on today's agenda.

Because of my professional background, I can offer some unique insights into the matters before the Subcommittee. Prior to accepting a faculty position at the University of Louisville, I was an attorney in private practice in Minneapolis, Minnesota. A major portion of my practice involved representing the interests of small firms in obtaining and protecting intellectual property, especially trademarks. In that practice, I had the opportunity to deal with some of the problems that can arise when firms attempt to use their intellectual property as collateral for loans.

I have continued to specialize in intellectual property during my academic career. I regularly teach courses in Law and Computers and Trademark Law. I have published several articles dealing with various facets of intellectual property law. I have also had occasion to deal with these issues from a more practical perspective. I have served on my law school's technology committee for several years, acting as chair for the last two. In addition, I regularly provide consulting services for the University's Office of Technology Transfer, focusing primarily on patents. In this same capacity, I recently helped rewrite the University policy concerning ownership of intellectual property in inventions and works produced by University faculty. Finally, for the past several months I have served on a university committee dealing with, among other matters, the use of computer technology in distance education.

My work at the University of Louisville has kept me in tune with the myriad problems that arise in connection with distance education. The University of Louisville is a regional leader in providing distance education. Although we, like many other universities, originally used only television technology, the past few years have seen various faculty experiment with the use of other technologies, including interactive synchronous video and asynchronous web-based classrooms. More recently, the Commonwealth of Kentucky launched a major new distance education initiative, called the "Commonwealth Virtual University," in which most of the Commonwealth's universities will participate. Because of these activities, I consider myself qualified to comment on each of the proposals before the Subcommittee.

Before dealing with the specifics of each proposal, I would like to offer a few general comments concerning both the Report on Copyright and Distance Digital Education and the proposal for a Federal Intellectual Property Security Act. Both documents deal with important issues facing modern intellectual property owners. Both deal with these issues in a comprehensive and well-considered way. The concrete proposals for legislative change in each document have been carefully crafted to deal with the problems identified. Therefore, I wish to make it clear that although my statement identifies and discusses certain problems with each document, the positive aspects of each document far outweigh the problems. The proposals for legislative change set out in the Report on Copyright and Digital Distance Education would, if enacted into law, go a long way toward ameliorating some of the problems posed by the use of digital technology in distance education. Likewise, the Federal Intellectual Property Security Act could easily be turned into a bill dealing with providing notice of security interests in federal intellectual property. Each of these proposals needs only a little "fine-tuning" to become effective legislation.

The remainder of my Statement will deal with each of the documents in turn.

Report on Copyright and Digital Distance Education

Throughout the history of the United States, there has been a tension between education and copyright. The ultimate purpose of copyright is to advance the general level of knowledge. This goal is reflected in Article I, § 8 of the Constitution, which allows Congress "To promote the Progress of Science and the useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." Yet, the system the framers designed sometimes works at cross-purposes with the ultimate goal of increased knowledge. That system seeks to advance the general level of knowledge by giving authors exclusive control over the fruits of their creative activity. However, neither the Constitution nor the enabling legislation contains a general requirement that authors and inventors disseminate their works. There is no general compulsory licensing requirement in the Copyright Act. Accordingly, a stubborn author may prevent release of her work, thereby denying society the benefits of her creative activity and potentially thwarting the pursuit of greater knowledge.

Recognizing this problem, Congress has exempted certain educational activities from the federal copyright laws. As discussed at length in the Report, § 110 of the Copyright Act creates several broad exceptions relating to education. Section 110(1) allows nonprofit educational institutions to perform or display any copyrighted work in the context of face-to-face education. Section 110(2) creates a prerogative to perform or display copyrighted works as part of an educational "transmission." That second exception, of course, directly pertains to distance education. However, the § 110(2) prerogative to transmit works is much narrower than the § 110(1) prerogative to use works in the classroom. For example, while a teacher may perform any work in class, he may transmit a performance of only nondramatic literary or musical works. That limitation would significantly impair an educational institution's ability to offer a distance course in, *e.g.*, "Modern American Film." Other provisions in § 110(2) further restrict the freedom to transmit copyrighted works in ways that do not apply in the classroom.

In addition to § 110, the fair use provision of § 107 may also apply to education. An obvious example of an educational fair use not covered by § 110 would be the use of an overhead projector to display a picture from a book or a passage from a novel or poem. Because the teacher has "copied" the work onto the overhead rather than performed or displayed the original, the § 110 exceptions do not apply. However, because the teacher has used only a portion of the work for educational purposes, and done so in a way that has little if any impact on the market for the work, that use would be a non-infringing fair use.

The Report on Copyright and Digital Distance Education focuses primarily on the educational exceptions of § 110, rather than the more general concept of fair use. Moreover, although it does discuss 110(1) at length, the Report concentrates on the transmission exception of § 110(2). Rather than burden the Subcommittee with a rehash of the Copyright Office's excellent analysis, I will provide only a cursory review of the major points, together with my own observations on the Report's recommendations.

In essence, the Report identifies two basic types of problems with the current legislation. The first are various technical problems posed by changes in the types of technology used in distance education. The second are various policy considerations designed to facilitate the use of distance education.

Technical Proposals. The Committee's proposals concerning the technical matters are contained primarily in Part VI(B)(3)(a)-(e) and (i). I fully agree with all of these proposals. For example, as both § 110(1) and (2) currently allow only "performance" and "display" of copyrighted works, a teacher may not rely on those provisions to copy a work. And yet, most distance education requires the creation of one or more copies, typically on a server. As long as these copies are merely incidental to the educational use, they should not constitute an infringement. Admittedly, such copying could constitute a non-infringing fair use under § 107. However, as the Report accurately points out, the fair use exception is too vague to provide much guidance to teachers and educational administrators who are conscientiously trying to avoid infringing a copyright. If distance education is to succeed, there is a clear need to amend § 112 to create the new "ephemeral recording exception" proposed in subsection (i) of the Report. For the same reasons, the subsection (b) proposal to add limited rights of reproduction and distribution is likewise very important.

On the other hand, the Report is also correct in noting that the exceptions should not be amended to the extent that they would effectively undermine the market for copyrighted academic works. In their current form, the § 110(1) and § 110(2) exceptions fit a specific paradigm—a single, time-limited performance or display of a work. Although promoting distance education may necessitate relaxing the current requirement that such performance or display occur in a traditional classroom environment, the basic notion that the student's exposure to the work be limited in time should be preserved. In essence, the student should be allowed only a single access to the work. A student who wants to archive the display or performance in order to review it at a later date should ordinarily be required to compensate the copyright owner. In this regard, the distance education student would be treated no differently than a student in a traditional classroom environment. For example, although a college professor is free to read a copyrighted text to his students, any student who wants a permanent copy of the text must either purchase it from an authorized source or obtain permission to copy from the copyright owner.

With respect to these technical issues, I am somewhat more confident than the authors of the Report that technology will develop in a way that will enable an institution providing distance education to meet this "single access" requirement. Although not infallible, the use of passwords has already developed to a stage where access to distance education materials can be limited to students enrolled in a course. Effective technological controls on printing and archiving works should also not be difficult to develop, if in fact they do not already exist. Therefore, in order to ensure that copyright satisfies its ultimate goal of promoting the progress of knowledge, an educational institution that uses such controls should be given relatively free rein to perform or display works, together with any copying and distribution incidental to that performance or display, in connection with distance education.

Policy Issues. Parts VI(B)(3)(f), (g), and (h) of the Report deal with broader questions of policy. Although I agree with much the Report has to say about these matters, I also disagree with certain crucial points in (f) and (g).

Section (f) deals with the ongoing dispute concerning whether the § 110(2) exception should continue to be available only to "nonprofit" educational institutions. I too have concern about a for-profit institution reaping profit from the free use of copyrighted works. On the other hand, given that the ultimate goal of copyright is to further knowledge, I would be hesitant to endorse a system that either denied for-profit educational institutions access to the same background materials available to non-profits, or made such access cost-prohibitive. I would suggest, however, that the issue is not as black or white as the Report makes it seem. Although it would be difficult to administer, Congress might want to consider the use of some sort of compulsory licensing regime for for-profit educational institutions. If works were available to those institutions at a reasonable cost, perhaps based on marginal profit, it would go a long way toward ensuring that for-profit and nonprofit educational institutions could utilize the same materials.

Section (g) suggests that the categories of works that qualify for the § 110(2) exception be expanded, but in only a very limited way. I strongly disagree with this particular recommendation. As noted above, distance education may open up a number of new vistas in the education process. Most significantly, it may give those of limited means, or those with limiting personal or family circumstances, the chance to obtain a college education. In order for distance education to realize its promise, however, the educational process must mirror as closely as possible the traditional classroom environment. In fact, most of the technological development in distance education is geared toward making the virtual classroom as much like traditional face-to-face education as possible. If the technology is there, it would be terribly unfortunate if the law placed greater restrictions on a teacher providing distance education than it did on the teacher in the classroom setting. Section 110(1) allows a teacher in the classroom to perform or display *any* work. The teacher providing that same class to a distant audience should have the same freedom.

Of course, distance education that is based on digital technology poses greater risks to the copyright owner. As long as effective technological controls can be developed, and educational institutions are required to utilize those controls, we can achieve a balance between the economic interests of the copyright owner and society's need for furthering knowledge.

A More Comprehensive Proposal. The observations of the last two paragraphs lead directly into my last recommendation. The mandate given to the Copyright Office specifically called for it to consider ways in which § 110(2) might be amended. Therefore, although the Report did deal with § 110(1) to some extent, the vast majority of the discussion focused on § 110(2). That focus, however, is unnecessarily confining. Were the whole question of how copyrighted works could be used in education to be considered anew, the result might be something more comprehensive than an amendment to § 110(2). In fact, a more sweeping change would actually do a better job in striking a proper balance between the needs of education and the legitimate interests of copyright owners.

I propose that § 110(2) be merged into an amended § 110(1). The new provision would apply equally to all education, regardless of whether it takes place in the traditional classroom or over a network. Like the current § 110(1), the new provision should allow the performance of any copyrighted work, not merely nondramatic or musical works. The other requirements of current § 110(1), such as the requirement that only lawful originals be used, should of course be retained. The new provision could also incorporate the § 110(2)(A) requirement that the performance or display be part of the education activities of the institution.

In addition, the new provision could incorporate many of the specific proposals that the Report makes concerning § 110(2). Because distance education poses greater risks to the copyright owner, an educational institution should be required to limit access to authorized students. Likewise, the institution should be required to use available technological controls to prevent unauthorized archiving or printing of works, or the dissemination of copies to third parties.

The goal of my proposal is for the law to treat traditional and distance education alike. That is, in fact, the direction that the technology is heading. Although I personally wonder whether distance education can ever fully recreate the dynamic that exists in the traditional face-to-face classroom, the technology may prove me wrong. If so, it would be unfortunate for the law to stand in the way of a process that could make quality education available to all. Therefore, the distance educator should have exactly the same prerogatives as the in-class educator.

In closing, I commend the Copyright Office for its comprehensive report and specific proposals for change. That Report will be a valuable tool for Congress when it decides whether the problems posed by distance education warrant a legislative solution.

Federal Intellectual Property Security Act

The proposal for a Federal Intellectual Property Security Act deals with a technical, but important, problem facing a wide variety of businesses. Federal patent, trademark, copyright, and similar laws turn inventions, works, and business symbols into valuable assets. By providing a limited monopoly for these assets, Congress has in essence created a new form of business capital. In fact, for many start-up companies, especially those in the biomedical industry, the capital represented by a patent or copyright is the company's main asset.

Marketing a new invention or copyrighted work often requires significant start-up costs. Because many authors and inventors simply do not have the money, they simply license their innovation to another. In many cases, these deals prove unsatisfactory to the author or inventor, as the royalty that they receive may be only a small share of the ultimate proceeds attributable to the invention or work. Realizing this, a growing number of inventors and authors forego the standard channels of distribution and attempt to market their intellectual property themselves. To obtain the start-up costs, these inventors and authors typically borrow money from a commercial lender. As the federal intellectual property right is the heart of the fledgling business enterprise, the institutional lender quite naturally takes a security interest in that intellectual property right as collateral for the loan.

There is already a well-established practice of granting security interests in intellectual property. The Proposal before the Subcommittee today deals not with the validity of the practice, but in the seemingly more mundane question of how the secured lender provides notice of its interest to others. Most security interests, regardless of whether they involve tangible or intangible collateral, are accompanied by the filing of a financing statement with a state registry. That filing "perfects" the interest, giving the lender priority over subsequent transferees and other security interests.

In theory, that same system would work for federal intellectual property rights. However, each of the federal laws dealing with intellectual property contains a provision governing how the right may be transferred. All of these provisions require that notice of the transfer be filed with the federal office responsible for overseeing that form of intellectual property. A transferee who fails to file the required notice runs the risk that the transfer will not be effective against a subsequent transferee of the same intellectual property right.

Although there is a difference between the grant of a security interest and an outright conveyance, most lenders already file notice of security interests in federal intellectual property with the appropriate federal office, usually in addition to a state filing. Because a default on the underlying loan may lead to foreclosure, this federal filing helps to ensure that the lender will take good title to the intellectual property interest in the event of foreclosure. All of the federal offices routinely accept these notices.

However, the current filing system has certain problems. First, as the Proposal acknowledges, there is some disagreement among the courts as to whether a federal filing is necessary to safeguard the lender's interest, especially in the field of copyright. Second, many commercial lenders take a security interest in all business assets, including property acquired by the debtor afer the date of the loan. While state filing systems based on the Uniform Commercial Code allow the lender to file a financing statement containing a general description of the collateral, the federal offices do not.

The Proposal has two basic goals. The first goal is substantive: to make filing in the federal office alone sufficient to protect the lender's rights. Although a lender would still be free to file in a state office, only the federal filing would ensure the lender priority over subsequent transferees. The second goal is to make the federal filing system more like current state UCC-based systems, by allowing for general descriptions of collateral.

The proposal is very well thought-out and carefully drafted. However, there are a few areas in which the Proposal might be improved. To this end, I have one general suggestion, and a handful of more specific recommendations.

General Comment. The Proposal makes a great deal of sense for security interests in copyrights, patents, boat hull designs, mask works, and plant variety protection. However, it is more problematic with respect to marks. Because there are significant differences between marks and other forms of intellectual property, making a federal filing an absolute prerequisite to priority is at best unnecessary, and quite possibly detrimental to the interests of lenders, owners of marks, and even consumers. I therefore recommend that if the proposal is introduced as a bill, it should be amended to exclude coverage of marks. Although filing notice of a security interest with the Patent and Trademark Office should by all means be allowed, it should not be a prerequisite for obtaining priority over junior interests in the mark.

Most federal intellectual property rights involve discrete, ascertainable interests. A patent is the exclusive right to make and sell a particular invention, as defined by the claims. A copyright grants a set of exclusive rights in a certain identifiable work. The laws governing mask works, plant variety protection, and boat hull designs also fit this basic paradigm. There is a one-to-one relationship between the federal right and the creation. In addition, the right granted by federal law is separable from the underlying object. An author or inventor may sell the physical embodiment of his creation without losing his copyright or patent. Therefore, the federal right and the physical creation each have a separate value.

A mark also relates to an identifiable business asset. Trademarks, service marks, collective marks, and certification marks are all symbols that represent the value of the goodwill that the owner of that mark has garnered over the years. But the similarity between marks and other forms of federal intellectual property ends there. First, unlike other federal intellectual property rights, a mark cannot be separated from the goodwill that it represents. A "naked" assignment of a mark (that is, a transfer of a mark without the goodwill of the transferor) is considered an abandonment of the mark, resulting in the loss of all rights in the mark. Section 10 of the Lanham Act (15 U.S.C. § 1060) incorporates this concept, and allows a mark to be assigned only along with the associated goodwill.

A second difference between marks and other federal intellectual property rights is that the protection of marks is not exclusively federal. Both federal and state laws afford protection to marks. Although registration of a mark under the Lanham Act does afford the owner of that mark certain additional rights, federal registration is not required for legal protection. A significant number of marks, especially service marks, are protected only by state law.

A third unique feature of marks is that there is not necessarily a one-to-one relationship between the right and the underlying asset. A person has only one patent in a given invention. A business may, by contrast, have a series of marks relating to the same good or service. It may, for example, claim rights not only in the stylized trademark it uses on its product, but also on the unadorned words alone. It may similarly use a symbol on the same product. In some cases, the distinct packaging or even a unique product design may function as a mark. It is not uncommon for a firm to register only some of its marks, relying on state law to protect the others.

The Proposal fails adequately to address the consequences that flow from these differences between marks and other forms of federal intellectual property. As written, the proposal applies only to marks that have been registered under the Lanham Act (although the Proposal fails to specify, I assume that this means registration under either the Principal or the seldom-used Supplemental Register of the Lanham Act). As a result, it applies neither to unregistered marks nor to the underlying goodwill of the firm. Security interests in these unregistered marks and goodwill must be perfected by state filings. Because a lender who takes a mark as collateral will invariably also take an interest in both the underlying goodwill and all other marks that pertain to that goodwill, the Proposal in effect creates a "dual-filing" system for marks, in which the lender will file in both the state office and the Patent and Trademark Office.

At best, this dual-filing system is an unnecessary redundancy. Admittedly, the burden of establishing and maintaining the system will not be that great. The Patent and Trademark Office already allows notices of security interests to be filed. The cost of converting that system to accommodate the new federal financing statement should not be that significant. Assuming that the filing fees remain reasonable, the additional cost to the lender of the second filing will be minimal.

On the other hand, what does the requirement of a second filing accomplish? As noted above, a mark cannot be separated from the goodwill with which it is associated. Therefore, any potential purchaser of an ongoing business will search for security interests in both the underlying goodwill and all marks associated with that goodwill. Because a state filing is necessary to perfect a security interest in the goodwill and any unregistered marks, the prudent buyer will automatically conduct a search of the state registry. If that search discloses that the goodwill is encumbered, that buyer has no need to conduct a second search in the appropriate federal office, for a mark is worthless without the underlying goodwill. Therefore, in the case of a mark, the requirement of a federal filing seems redundant.

Moreover, in certain situations the dual-filing system may actually have a detrimental effect. Although a careful lender would file with both the Patent and Trademark Office and the state registry, it is possible that a lender might comply with the requirements of one system but not the other. Suppose, for example, that a lender files a proper federal financing statement, but fails to make a proper state filing (it might, for example, have filed with the wrong state). That lender would have a perfected interest in the federal mark, but not any state marks or the underlying goodwill. Suppose further that the debtor later sells its business, including the goodwill, to a third party, pursuant to a sales agreement that makes no mention of any federally-registered marks. As the Proposal is drafted, if that third party had no actual notice of the lender's interest, it would take free and clear of the security interest. Although the federal filing might otherwise serve as constructive notice, the third party would have no reason to search the Patent and Trademark Office filing system, as it was not purchasing any federal marks.

Of course, it might seem as if the lender in this situation has merely suffered the consequences of its carelessness. However, one other consequence may result from this sequence of events. After the conveyance to the third party, the federal mark and the goodwill are owned by different parties. This separation of the mark and the goodwill results in abandonment of the mark, destroying its entire value. This possibility of abandonment certainly affects the lender, and will invariably be reflected in lending rates. Moreover, abandonment of the mark may also affect innocent consumers. After abandonment, anyone is free to adopt the mark for use on its own goods or services. Because consumers rely extensively on marks to make purchasing decisions, the unintended dissociation of the mark and the goodwill of the original seller is likely to cause customer confusion—precisely the sort of confusion that the Lanham Act is designed to prevent.

Admittedly, the scenario set out just above is somewhat unlikely. But given that the requirement of a federal filing is redundant anyway, the risk of customer confusion is a further reason to question the desirability of a dual-filing system. Although allowing a federal filing for marks is commendable, actually *requiring* that filing as a prerequisite to protecting the lender's interest may well prove to be unwise. I therefore suggest that any future federal intellectual property security act omit marks from the compulsory filing provision.

Specific Comments. I also have a few specific comments concerning the Proposal, which I have referenced by the section numbers used in the Proposal.

Section 2(6)(b). If the act is to include federally-registered marks, this clause must be amended to include a reference to the Commerce Clause. The Patent and Copyright Clause of Article I, § 8, cl. 3 cannot serve as the basis for federal laws dealing with marks. That clause allows Congress to provide protection "for limited Times." Protection of a mark is not limited in term, but continues for as long as the owner uses the mark. Moreover, Article I, § 8 allows Congress to give rights only to "Authors and Inventors." Authors and inventors innovate. Legal protection of a mark, by contrast, does not require innovation. Rights in a mark vest in the person who has used that mark in connection with a given good or service for the longest time. That senior user has rights even if she copied the mark from someone else who used it for a different good or service.

Section 3(b)(2)(B). This provision is the heart of the entire Proposal, and therefore warrants close scrutiny. As written, filing a federal financing statement protects the secured party against subsequent transfers of the federal intellectual property. "Transfer" is defined in section 3(a) to exclude security interests. Therefore, as written, the Proposal nowhere provides that filing a federal financing statement gives the lender priority over junior security interests. Lenders could, of course, obtain that priority under state law by making a second filing with the state office. To eliminate that need, however, this provision should be amended to provide that a federal filing gives the lender priority not only over subsequent transferees, but also over junior security interests.

Section 3(b)(3)(B). I would recommend that the parenthetical phrase ("and, in the case of Federal marks, the goodwill of the business connected with the use of and symbolized by such Federal marks") be deleted. Goodwill is not a federal intellectual property right. Therefore, even if the Proposal becomes law, lenders will continue to perfect security interests in goodwill by filing with state offices. A potential purchaser of that goodwill will continue to search the state filing systems to determine if the goodwill is encumbered. The wording of this section, however, could be construed as allowing a lender to perfect a security interest in goodwill by filing either a state or federal financing statement. This in turn would force all purchasers of an ongoing business concern to conduct a separate search in the Patent and Trademark Office, in the off chance that the seller also has a federally-registered mark connected with that goodwill. Due diligence would require a federal search even if the purchase agreement did not mention federal marks.

Second, I am somewhat uncomfortable with the last clause of this section, which provides that a reference to "intellectual property" or "general intangibles" in a federal financing statement is sufficient to cover not only intellectual property that already exists, but also any federal intellectual property produced at a later date. I realize that whether that after-acquired property is actually subject to the security interest is governed by the security agreement, not the financing statement. However, if an author or inventor should later produce another work or invention, a subsequent lender may be hesitant to lend money out of fear that the new invention is already subject to a senior security interest. Without this clause, subsequently produced intellectual property would be covered by a financing statement only if that statement contained a specific after-acquired property clause. Requiring a specific reference would give the author or inventor who foresees acquiring additional copyrights or patents the chance to negotiate the language employed in the financing statement.

Admittedly, section 3(b)(3)(6) could address this problem. That section makes the lender responsible for any damages that the debtor suffers due to an improper financing statement. However, as the Proposal is written, a lender is perfectly free to file a federal financing statement containing broad language like "general intangibles," even if the security agreement does not actually reach after-acquired property. Therefore, if the damages action provided by section 3(b)(3)(6) is deemed an adequate deterrent, it should be amended to cover the problem of after-acquired property.

I thank the Subcommittee for the opportunity to present my views on these matters, and hope that my comments will help you in any further action you may take on these proposals.

Mr. COBLE [Presiding]. Thanks to each of you.

We have been joined by the distinguished gentlemen from Tennessee, Virginia, and Massachusetts, Messrs. Jenkins, Boucher, and Delahunt. Good to have them with us.

Ms. Schroeder, how do you respond to concerns of educators that it is too difficult and too impractical to license works for use in digital distance education?

Ms. SCHROEDER. Well, I think iCopyright answered that. They are tying to make it easier, and licensing certainly is going on. There are many of our publishers very excited about distance education, wanting to get into that market.

But the other point I was trying to make, too, not only in licensing but orphan works, a lot of these things are issues where we need to update rights holders being able to participate, and do it quickly. And I guess what I am saying is where you really find that we are going in distance education, is moving very rapidly with good products right now and they are getting—they are getting there by either producing it themselves or by public domain or by using fair use or by using licensing. So licensing is very broad based, and people are using them a lot.

Mr. COBLE. Mr. Attaway, if Congress followed the recommendations of the Copyright Office and expanded the categories of works covered by 110(2) to include audio-visual works, how would the market of audio-visual works be affected?

Mr. ATTAWAY. It is unclear. If the requirements of effective technological protection against unauthorized access and use actually are met, I think there would be very little impact. Our concern is that until this technology actually exists, it is very dangerous to change the law permitting this type of activity without defining precisely the kind of technological safeguards that need to be applied. And if they are not applied, the impact can be horrendous. You can imagine recent motion pictures appearing on the Internet. That is going to be a problem for us in any case, but it will be materially exacerbated if educators have the legal right to transmit this type of programing to their students digitally and then it leaks out onto the Internet and elsewhere. That is our concern.

Mr. COBLE. Ms. Gasaway, the Copyright Office Report suggests amending section 110(2) to cover certain digital distance education activities. It has also been suggested that in lieu of amending the law, that Congress should encourage the parties to continue pursuing fair use guidelines to address these issues. Do you believe that guidelines are helpful in this area and do you believe that they could substitute for legislative changes?

Ms. GASAWAY. Mr. Chair, I do not believe that guidelines can substitute. I come at this as a warrior for guidelines, having been the principal draftsperson on the failed CONFU attempt on distance learning guidelines and spent about 2½ years working on that. And even during that time period, what we found was the technology changing so rapidly that anytime we begin to get a handle on what was happening, the technology changed considerably.

Beyond that, I think the CONFU process has actually poisoned the environment for guidelines right now and that we are better served to look at a statutory exemption that has protections for the copyright holders. Maybe in the future sometime we could look again toward some best practices that we could develop, that sort of thing. But I think guidelines right now are pretty much out of the question as far as really solving the problem because when you have a statute that says you can't use these works, how do you work fair use, other than a small portion? It just doesn't work very well.

Mr. COBLE. Thank you. I have questions for Mr. Ochsenreiter and Professor Cross but I will suspend. I will withdraw until we go the full round. The gentleman from California.

Mr. BERMAN. Thank you very much, Mr. Chairman. I think Mr. Ochsenreiter on this panel solved the problem of the second bill; we just record the liens on copyrights on iCopyright and maybe privatize the Copyright Office. I don't know. In any event, it was a very interesting proposal you spoke about.

I would like Pat and Fritz to respond to the two professors' points because—particularly Professor Gasaway's point. She says she doesn't dispute the fact that technological protections aren't there and she says, but look, a lot of distance education is not digital, and therefore not changing these sections because of the absence of the technological protections will impede non-digital distance education. And, in fact, my guess is then you would—would you support a proposal that eliminated the notion that transmissions include digital transmissions or specifically excluded digital transmissions in order to further non-digital distance learning at this particular point and then we can evaluate on a yearly basis whether or not the protections are reasonable and effective?

Ms. GASAWAY. Ten years ago I certainly would have supported that. Ten years ago.

Mr. BERMAN. But it wasn't particularly meaningful?

Ms. GASAWAY. Well, it was certainly meaningful for those of us in education who were doing distance— —

Mr. BERMAN. No, no, I wasn't meaning to exclude digital.

Ms. GASAWAY. But today excluding digital is very shortsighted and that is what CONFU tried to do was to exclude digital and one of the reasons those guidelines were never accepted was because they did not deal with asynchronous delivery, and so I think it really doesn't solve the problem.

Mr. BERMAN. But then you can't—I have to say, but then you can't argue that we are impeding non-digital distance education even though there is not adequate copyright protections. In other words, the thrust of your argument was, yeah, I recognize we don't have adequate technological protections in the digital world but by not changing anything, you are impeding non-digital distance education; but now you are insisting we include the digital world.

Ms. GASAWAY. You asked me if I thought it would work. And, yes, it would work for the non-digital. But here we are faced also with the digital. And suppose that in 6 months, then, we have those technological measures developed; do we then have to come back through a whole hearing process? Why don't we have technology-neutral kinds of things——

Mr. BERMAN. Who decides when the technology is there?

Ms. GASAWAY. I suppose the industry does that, finally says——

Mr. BERMAN. Which industry? The distance learning industry? The copyright protection industry?

Ms. GASAWAY. The industry that develops software that looks at kinds of protections. I mean, I think there will be industry standards. If the RIAA is willing to let their music be distributed digitally, then at some point they are going to have to be satisfied that there are those controls there. I don't think it is up to us to sort of name what they are. I am not a technology person. I can't do that. But there are people who are technology folks and can specify what those technologies are.

And I want to say I don't know whether the technology is there today or not. I don't think it is and I am hearing from the content providers that it is not. But it may be, or it may be there tomorrow or another week or 6 months. We just don't know.

Mr. BERMAN. Professor Cross, do you think it is there?

Mr. CROSS. Like Professor Gasaway, I have no reason to think it is there. I do know that parts of it are there. I think password controls are fairly effective. I think it would not be that difficult to limit access to the work to students actually enrolled in a class. That goes a long way toward controlling dissemination right there.

Mr. BERMAN. I think the university—the university non-credit course—the direction of the film industry in 1999—for 50 cents a student, digitally transmitted could produce a very large classroom when you include entire audio-visual works within this.

Mr. CROSS. I fully agree, but if that is—I don't really see universities doing that. We can do the same thing now in class. We could set up a huge auditorium, charge 50 cents a person and show films in the classroom environment. It is not happening.

Mr. BERMAN. It is not a big enough auditorium. There will be a university in an unlimited auditorium. But in any event, just Mr. Attaway, Ms. Schroeder, I would be interested in your take on their formulation.

Ms. SCHROEDER. I just want to quickly say I have never seen a law that could create technology. The Copyright Office and I think both of the witnesses are saying they don't think the technology is there right now or at least they are not aware of it. And if you say then passing the law will incentivize companies to go out and devise the technology, I don't really think that has ever happened before. That would be very historic. There are a lot of people working on the technology but it is not there and a new law probably won't make it happen.

The other thing I think you have to realize is part of the pricing of this is going to be whatever it costs people to protect post-access that is illegal. And that means you will have to buy that technology, so I think we all have a vested interest in making sure that the technology is available and is affordable because it will be part of the pricing.

Mr. ATTAWAY. The only thing I can add is that if there is a problem with non-digital distance learning, I haven't been aware of one; but if there is one, then I think that is something that we can address and I am perfectly willing to address it. But until the technology exists in the digital environment to create the protection that everyone recognizes has to be there in order to make it work, I think it is premature to legislate.

Mr. BERMAN. Mr. Chairman, my time is up. If I could just, though, in one closing sentence say I believe that the folks that these two witnesses represent, the day there is reasonable technology protection available, the fastest people in the world to exploit that, to encourage distance education and quick licensing, will be these folks because it will be in their economic interest to do it.

Mr. COBLE. I thank the gentleman. The gentleman from Tennessee, Mr. Jenkins.

Mr. JENKINS. Mr. Chairman, I don't have any questions at this time. I would be perfectly willing to yield my time to the gentleman from California if he would like additional time.

Mr. BERMAN. I will wait until we come around.

Mr. JENKINS. Or to the expert from the Commonwealth of Virginia.

Mr. COBLE. I thank the gentleman. And the gentleman from Virginia is recognized.

Mr. BOUCHER. Mr. Chairman, thank you very much. I would be remiss if I didn't say a word of welcome this afternoon to two veterans of the House Judiciary Committee, and we are very pleased to have former Congresswoman Pat Schroeder with us, former ranking member of this subcommittee, and also the gentleman from Kentucky, Mr. Mazzoli, who during his time on this committee chaired with great distinction the Immigration Subcommittee. We are delighted to have both of these former members with us. I am sorry to have to remind Mr. Mazzoli that in the days since he left, there has been a change here in the Congress. He is now seated on the wrong side of the dias.

Mr. MAZZOLI. It is probably not mine to respond, but I thank the gentleman. I thought about it after I walked up here. I appreciate this.

Mr. BOUCHER. We are delighted to have you up here nonetheless. Distance learning is a great thing for rural America. As a matter of fact, in my congressional district, which is entirely rural, consisting of 23 counties and cities, we now have a fiberoptic-based digital distance learning application that connects 55 high schools, community colleges, and 4-year colleges. It is a technology that accommodates voice, video, and data; and the legal foundation upon which it accommodates at least two out of those three applications is somewhat in question.

In my district, as in much of the rest of rural America, this is a way that students who are born and raised in counties that have a small population and few financial resources can have access to the same advanced courses that the young people who are born in the wealthier localities currently have access to. And so through distance learning we are able to render distance unimportant, and the accident of the place of a person's birth doesn't determine the quality of that person's education. It really is a remarkable advance for rural Americans.

Back in 1976, Congress, recognizing that distance learning offered great opportunities for rural areas in particular but not just limited to rural areas, that other parts of the Nation also will benefit, enacted an exemption for the kind of technology through which distance learning was promoted in that day, and that was for broadcast technology. This was before the birth of digitization, and this broadcast analogue technology was reasonably well-encompassed by the exemption passed in 1976.

But now the world has changed and digital technology is increasingly used, and in my district it is exclusively used and we are using it to great effect. In the effort to make sure that what has been done by analogue technology and by the broadcast exemption can be done in the future, using digital technology, this Congress required the Copyright Office to examine what changes in law were necessary to achieve that result, and the Copyright Office, I think, has done an outstanding job in carrying forward that mandate and making recommendations to the Congress.

And so today I simply strongly want to urge that legislation be drafted at the earliest possible time to incorporate the very sound and well-considered recommendations of the Copyright Office, brought to the floor of the House as soon as possible, and passed during this 106th Congress. And I will very strongly be supporting that effort.

I do have a couple of questions and I would primarily like to address these to Ms. Gasaway and also to Professor Cross, and they concern various aspects of the Copyright Office's recommendations.

First of all, there is some concern, I think, among the users of distance learning technology about the general availability and timeliness of licensing, and I would like for you to comment on the extent to which you perceive that to be a problem at the present time, the extent to which you perceive that—my glasses aren't really good now to pronounce this gentleman's last name but the gentleman from, I believe it is iCopyright.com.

Mr. OCHSENREITER. iCopyright.

Mr. BOUCHER. And the proposals that his company are now putting forth and their capabilities might be a solution to the inadequacy of licensing availability presently, and also whether you think perhaps we ought to, as we consider legislation, require that a follow-up study on the availability of licensing be performed perhaps 2 or 3 years from now, with a recommendation to the Congress for any changes that we need to make to accommodate any remaining shortage in the availability or timeliness of licensing as it may exist at the end of that study period, and whether that would be a good idea.

I have used my time asking one question. I am sorry. Let me give you a chance to respond.

Ms. GASAWAY. Thank you. In the CONFU process, we did gather a great deal of information about the difficulties with licensing. Some educational institutions find that when they try to contact a copyright holder, get no answer whatsoever. The time passes. We even saw an example of a distance learning course where there were both students who were in the classroom and some that were remotely located. Those in the classroom saw the film. There was a blackout, literally, on the television that said, "for the next 20 minutes the students in class are watching the tape."

So licensing has been a difficulty, an existing difficulty for educational institutions. There was also a report of a request for using 6 minutes of a motion picture to 30 distance-learning students and the fee quoted was $27,000 for one-time use, which is out of the question for nonprofit educational institutions. And for 30 students, I guess you could have collected—what would that be—$900 a person or something to see that film. It seems a little steep, even with movie prices going up, for seeing motion pictures. That seems a little steep.

On the issue of iCopyright, iCopyright is dealing with providing textual material, providing copies of literary works, and I think it can be extremely helpful for distance learning when it is talking about providing course pack material and that sort of thing to the class. It doesn't have anything to do with performance and display and the recommendation that section 110(2) be amended.

Mr. BOUCHER. Do you think that a follow-up study on licensing availability would be beneficial?

Ms. GASAWAY. It certainly might be. I don't think the track record with follow-up studies and copyright has been really strong.

Mr. BOUCHER. This particular follow-up study did make some very helpful recommendations.

Ms. GASAWAY. The first study is always helpful. I am talking about the follow-ups that follow those, thinking specifically about the old section 108(i) follow-up studies on how photocopying was working in libraries. Two of those were done and finally people said it was too hard to do it and it was not producing any new information. Perhaps one follow-up on licensing might be useful. I really don't have much of an opinion on that.

Mr. BOUCHER. Could we get Mr. Cross just to comment on the general question?

Mr. CROSS. I also think licensing has a great deal of promise. I am heartened by the efforts of iCopyright and groups like that. To me, though, that still doesn't address the issue of when one should have to obtain a license. I think Professor Gasaway and my points both dealt with when should there be free use of works and our point, I think, is if you can use it in the classroom, and we can recreate a digital classroom with those same controls, then licensing ought not be an issue. There ought to be an exemption for that.

Mr. BOUCHER. Thank you. Mr. Chairman, my time has expired. I have some other questions but I will wait until we have a second round.

Mr. COBLE. Very well. The gentleman from Massachusetts.

Mr. DELAHUNT. I thought your comment was interesting, Professor. I mean, what you are talking about is when free use of a copyrighted work should be triggered by an exemption. I mean, I think that is really getting to the crux of the issue, so to speak; but I am going to just put that aside for a minute because I thought that was an interesting comment. I think both the ranking member, Mr. Berman, and Mr. Boucher have really explored what I was going to ask, because according to your testimony, Ms. Gasaway, the problem is license availability; because, as Mr. Berman indicated, when the technology becomes available, the constituencies represented by Ms. Schroeder and Mr. Attaway will, I presume, be very active promoting that particular market. It is in their economic interest. And I can understand a reluctance to support legislation that would be anticipatory of the arrival of certain technologies, and yet the gentleman from i.com——

Mr. OCHSENREITER. iCopyright.com.

Mr. DELAHUNT. You can tell how often I use the computer—gives us some hope and optimism that that is not—no pun intended—but not in the distant future.

But I guess probably my question should be directed to Ms. Schroeder and Mr. Attaway in terms of the license availability issue, because what you are saying is that in the example given by Chairman Coble in terms of one campus in Greensboro, the transmission of that same information, that same material to another location was prohibitive. In listening to you, I guess my first thought was, why don't you just negotiate it out in the private market and expand the license? But what you are saying is that the cost is too prohibitive.

Ms. GASAWAY. Also the copy of the film has been purchased by the educational institution, so the free use is only in the performance. When you have already purchased the film, it is not that you haven't paid for anything. You have paid for it. It is just that to show it in the classroom, there is no requirement of a license. That is the issue. To show it to distance-learning students even if there are just a few of them, there is a requirement of a license.

Mr. DELAHUNT. But the question is still posed: Why not secure the license?

Ms. GASAWAY. Because they are not securable often. Frequently people are simply told no when they approach and ask to have a license to show a film.

Mr. DELAHUNT. That is why I was commenting that your—in response to the question by Mr. Boucher, you defined for me what your perception of the problem is, and I guess I am going to ask Pat Schroeder and Fritz Attaway if they have a comment on your understanding of the issue, availability as well as cost.

Ms. SCHROEDER. Well, many of our publishers who are doing distance education are doing it by getting licenses. Licenses are there and people are licensing. If the issue is you have to pay for them, remember the rights holder does have the right to ask price and if you don't want to pay that price, you could go somewhere else and find something else. This is how the system works.

Now, I understand that it is not quite as easy as if you had one central location, and maybe we will soon have technology that can bifurcate and do that and price content differently. Sometimes copyright holders don't answer as fast as others would like them to. But authors should be here. Publishers are entrusted to bargain for authors' rights and writers' rights. All sorts of people have a piece of this action. While it would be nice to have everything free in this country, you know, tuition isn't free, computers aren't free, so why should content be free? We know all sorts of things aren't free, and licensing is there, it is available,and much distance education is using it very readily.

Mr. DELAHUNT. Thank you.

Mr. ATTAWAY. Mr. Delahunt, may I respond just very briefly? I think I said in my written testimony, there are inevitably cases where users wish they could receive copyrighted material that is either unavailable or available at a price that they consider to be too high, and there will also be anecdotes, unfortunately, as Professor Gasaway gave us, a few appear to be outrageous; $30,000 for a 6-minute clip for 30 students.

But the real issue here is whether the lack of additional exemptions in the copyright law are interfering with the effective education of students in this country, and I haven't seen evidence to that effect and I don't think there is evidence.

Mr. COBLE. I thank the gentleman.

Professor Cross, I was going to ask you a similar question but Mr. Delahunt pretty thoroughly covered it.

Mr. Ochsenreiter, in your testimony you discussed that iCopyright is currently involved in a pilot program of the on-line licensing technology. How have the copyright owners and copyright users reacted to the program so far and have there been any difficulties with the technology that could affect the launch of the program to the general public this fall?

Mr. OCHSENREITER. Mr. Chairman, we are at the beginning of the pilot program. We are in a technological process of setting up the capability from the publisher's perspective. We have enlisted many, what we call corporate users, for the pilot program as well, which I did not name. And so I can't answer your question in terms of the pilot program having produced that level of response yet.

At this point we do not believe that our goals for launch this fall are ambitious beyond our being able to deliver them. There are many capabilities we will be bringing on-line subsequently this fall as well. It is a complex technological challenge.

If I might set the record straight on one element, Mr. Chairman. iCopyright.com is not just involved in the licensing of textual material. It is textual and digital material of all kinds and would include the audio and visual material as well. The licensing technology clearance engine that is behind us will work for any of those elements. Of course, it would be up to the content owner if they thought or were comfortable with the protective securities technologies that we will support as well, whether or not they would want to make available copyright clearances for audio-visual works.

Mr. COBLE. Thank you, sir. The gentleman from California.

Mr. BERMAN. Well, I would—I would like someone to join issue with Mr. Attaway's last comment in response to Mr. Delahunt's question. Could you give me, in terms of specifics, the example of the kind of curriculum that was held back from students in rural areas and far-flung areas through distance education mechanisms as a result of the limited nature of the—I guess it is the 110(2) exemption. I mean, in terms of—put it into real specific kinds of context so I can see what we have kept from students as a result of that.

Ms. GASAWAY. The example I was giving you was a distance education course offered by Kent State University, and the course was a political science course, and they were seeing a documentary film and could not get the rights to show it even to only their enrolled distance-learning students. So consequently there was a black box shown on the screen. Now, I think we could gather these examples.

Mr. BERMAN. There was a black box?

Ms. GASAWAY. For the distance-learning students there was a sign that said, "Students in the live classroom are now seeing this film.".

Mr. BERMAN. Oh, because——

Ms. GASAWAY. They couldn't get the license to show it to the long-distance learning students.

Mr. BERMAN. It is a funny thing for the professor to decide to do. He has the whole distance learning thing and he is using material that can't be communicated.

Ms. GASAWAY. That is why I say it is very counterintuitive to teachers. They have been teaching this course and now all of a sudden there are distance-learning students in the course, in addition to ones who are in the classroom, and both are live time. We could gather these examples. Some of them I believe were presented to the Copyright Office, but our associations can gather those if you are interested in that kind of evidence. We certainly can put that together.

Mr. BERMAN. My guess is the professor who wants to teach through distance learning a course in the culture of the 1960's, is going to have to pay an awful lot of money to get the print of the Austin Powers movie—and then is that an argument for—what does that prove?

Ms. GASAWAY. The argument is not that the film costs too much because the institution has purchased the film.

Mr. BERMAN. No, they haven't. They want to.

Ms. GASAWAY. No, they usually have. They own a copy of the film, a legitimate copy that they have paid for. Now what they want to be able to do is to transmit it to their distance-learning students. That is what the act doesn't allow them to do. We are not talking about materials that they don't own.

Mr. BERMAN. I thought you were making a point about how expensive some of the—in other words, the licensing wasn't just a matter of cumbersome, difficult connecting. It was too expensive and some things are going to be too expensive.

Ms. GASAWAY. That is correct, but it is not that the institution hasn't purchased the film. They own a copy of the film. It is the rights to perform and display it that are too expensive. So it is not that—when we say "free use," it is not that they haven't purchased the item. That institution owns maybe multiple copies of the item that they have purchased.

Mr. BERMAN. Would they be willing to pay more to get the license to distribute it through distance education?

Ms. GASAWAY. Well, right now——

Mr. BERMAN. Because maybe the price they got it for, limited to a classroom, was a different price than the market would bear for distributing it to any distance education content.

Ms. GASAWAY. I think we would have to talk about whether the price is reasonable, whether it is offered up front, all of the things about just sort of licensing. But certainly some institutions are paying for those critical items so that they can show them.

Mr. BERMAN. So it might include audio-visual works prospectively only, so that people who got licenses for works in terms of classroom context can't utilize that to transmit.

But in any event, thank you, Mr. Chairman.

Mr. COBLE. Thank you, Mr. Berman. The gentleman from Virginia, Mr. Boucher.

Mr. BOUCHER. Thank you very much, Mr. Chairman. Just a couple of additional questions to Ms. Gasaway and to Professor Cross. One of the recommendations of the Copyright Office is that there be an exemption for ephemeral recordings which are necessary as a part of the process of transmission of digital material. What is perhaps not clear is whether or not that recommendation also extends to the entry of the material to be transmitted into the server initially. And I am wondering, do you perceive that perhaps the recommendation is not complete enough to accommodate that essential transaction; and, if you agree with me, that it needs to be.

Mr. Cross.

Mr. CROSS. Personally, I would like to see it added. I mean, when I first reviewed it, that thought did come to mind. As I interpreted it, that would be making a copy incidental to the ultimate performance and it probably would be all right. But certainly the clearer the amendments could be made the better, in my view.

Mr. BOUCHER. Ms. Gasaway?

Ms. GASAWAY. I agree.

Mr. BOUCHER. We are operating on the assumption for the purposes of these questions that we are going to have legislation, and when we do, it would be important to accommodate that act as well as the act of transmission and any ephemeral copy that is made incidental to it.

The other question that I have relates to the recommendations with regard to exemptions for portions of audio-video works. And my question to you is really a very practical one, and that is, how useful are mere portions of film clips or recordings of text materials going to be in carrying out the distance-learning function, and of what value really is an exemption that only extends to portions of those works?

So address the issue of portions, if you would, and let's hear a recommendation from you if it is different from the Copyright Office's as to how we should treat that subject.

Ms. GASAWAY. Our organizations would like to see no portion limitations when there are the technological controls for downstream copying and limiting access. If those do not exist, then some other limitations may need to occur, like portion limitations. It is very difficult to generalize when you talk about distance education courses, because some of them work very well using short clips. If it is a course on American culture and you are trying to show different film clips and television clips, that may be certainly adequate. But what if it is a biology course and the film is a 20-minute videotape on your digestive system? Which portion do you not want to see? You want to vote to omit the large intestines?

Mr. BOUCHER. I don't want to see any of it.

Ms. GASAWAY. There are some types of works where you have to see the entire work for the educational purpose. But I think it varies so much based on the kind of course and the instructor's purpose.

Mr. CROSS. The only thing I would add is portion limitations have the same problem as fair use and fair use guidelines. They are very, very vague. Sixty percent of a film may not be the crux of a film. On the other hand, 20

percent of the film could be. I am not sure how we define portion limitations in a meaningful sort of way.

Mr. BOUCHER. So maybe the place to wind up with this is to create a balance where if the environment within which the transmission occurs is made very secure, with complete limitations on the ability to download material on the receiving end and perhaps use it for unlawful purposes in those instances, the entire work could be transmitted with some certainty that it would not be copied for illicit purposes. And then in a less secure environment, perhaps a lesser part of that volume of material could be transmitted.

I think I have only one other question and that is the question with regard to technology controls. The Copyright Office, I think, properly recommends that efforts be made to, through technological means, inhibit unlawful copying of materials transmitted digitally. I think there is a concern, however, and I would like to get your response to this, about the ability of some school districts, perhaps the ones that need distance learning the most, the ones that are the smallest and have the fewest financial resources, to be able to afford some of the technological controls. We really don't know what the controls are. They are not specified in the report.

Would you have some recommendations for us in terms of language for a potential statute that might help to strike the balance between having good technological controls, but making sure that they are in fact affordable for those school districts that have few resources and really need distance learning the most?

Mr. CROSS. I am not sure how we deal with that as far as statutory language.

Mr. BOUCHER. I don't either. That is why I ask you.

Mr. CROSS. I figured as much. In my written statement, I do make sort of an offhand proposal that one idea might be some sort of freeware system operated perhaps by the Copyright Office. The sorts of technological controls that are out there are often available by freeware anyway and if the systems do develop, if the Copyright Office wants to help further distance education, it can make that sort of software available for download to recognized organizations. That would be one way to solve the financial problem.

Mr. BOUCHER. Ms. Gasaway?

Ms. GASAWAY. I think I have been concerned when we talk about technological controls that a school that is doing this would like to have one system, not have to have different systems for different publishers' materials. That would become very expensive if that is what we had, where a publisher controlled or producer controlled systems. But I think there will be some industry standards developing and I like the idea of freeware or very inexpensive software that might come along that would help school districts.

I have no idea what it might cost to do this but if, you know, if you have an institution that is willing to go off and develop their own, even at great expense, maybe they should have the right to do it earlier than those that are going to have to depend on freeware. I don't know.

Mr. BOUCHER. Well, the institutions in my district can barely afford the technology for distance learning itself. The rent on the fiberoptic lines, for example, is about 1,500 per month. Even that is a deeply discounted rate, but that is a struggle for these very financially unfortunate school districts where the distance learning really makes the greatest difference.

Well, we need to explore the subject of technology further and I very much value your answers to these questions. Thank you.

Thank you, Mr. Chairman.

Mr. COBLE. Thank you.

Mr. Berman, I think, has one final question.

Mr. BERMAN. Thank you, Mr. Chairman. One more time, explain to me this issue of accepting the balance of expansion—broadening the exemptions in the digital context when the technological controls are meaningful and real, and how that is decided. What if someone says, oh, we have a requirement, everyone has to have a password to get it. Is the fact that they say it enough to make it available? Is everybody going to be subject to litigation afterwards about whether it was really an effective protection? Doesn't the legislation need some kind of standard, Professor Cross?

Mr. CROSS. I would suggest a standard that may be vague, something like the reasonable use of available technological controls, and specify the purpose of those controls.

Mr. BERMAN. But available—what if available controls aren't effective?

Mr. CROSS. If the available controls aren't effective to meet the specified goals, namely preventing downloading and dissemination, then I think——

Mr. BERMAN. Preventing access to somebody who didn't pay the cost, preventing retransmission.

Mr. CROSS. Exactly. You specify in those goals that you must use reasonable efforts to prevent these sorts of things from happening based on the available technology.

Mr. BERMAN. What if there is no available technology?

Mr. CROSS. If there is no available technology, then educators, until such technology becomes available, will resort to other means, transmission sorts of means, as Professor Gasaway discussed.

Mr. BERMAN. Who decides?

Mr. CROSS. Anytime there is an imposition of a reasonable standard, it is decided by the courts.

Mr. BERMAN. So it is an after-the-fact litigation, case-by-case determination of whether there is an alternative, whether it was reasonable, and whether it was limited to the goals specified.

Mr. CROSS. Unless the Copyright Office or some agency wants to get involved in rubber-stamping; in saying this sort of control is, per se, effective; yes.

Mr. COBLE. I thank you all. These are early steps of many steps to follow. I am sure this discussion will be continued and we thank you for your contribution.

I will now call the second panel to the table and introduce them as they make their way forward. The first witness of panel two will be Susan Montgomery who is a partner of the law firm of Foley, Hoag & Eliot, LLP. She is testifying on behalf of the American Bar Association. She has experience in the areas of intellectual property, international transactions and commercial law. Ms. Montgomery received a B.F.A and M.A.E. From Rhode Island School of Design and her J.D. from the Northwestern University School of Law.

Our next witness is Mr. Charles G. Johnson who is the President and Chief Executive Officer of the Allstate Financial Corporation. He is testifying on behalf of the Commercial Finance Association. Mr. Johnson is First Vice President of the Commercial Finance Association, the national trade association of the factoring and asset-based lending industry, and will become its President in the year 2000.

Our next witness is Lorin Brennan who is a California attorney testifying on behalf of the American Film Marketing Association. Mr. Brennan specializes in international intellectual property licensing with an emphasis on motion picture distribution and financing. He received his B.A. In mathematics from the University of California, Santa Cruz and his law degree from the University of California Hastings College School of Law.

Our next witness is Anne Chasser who is the Director of the Office of Trademark and Licensing Services at Ohio State University. She is testifying on behalf of the International Trademark Association. She is a recognized expert in trademarks and collegiate trademark licensing and manager of the commercial use and positioning of university trademarks. Ms. Chasser earned her M.A. From the Ohio State University.

And our final witness is our old friend, Mike Kirk, that is not to say that you others are not friends as well, but Mike is an old friend. He is the Executive Director of the American Intellectual Property Law Association. Mr. Kirk served as the Deputy Assistant Secretary of Commerce and Deputy Commissioner of Patents and Trademarks from May 1994 through March 1995; and in 1993, Mr. Kirk also served as the Acting Assistant Secretary of Commerce and Acting Commissioner of Patents and Trademarks.

Mr. Kirk earned his bachelor of science at the Citadel in South Carolina and his J.D. from the Georgetown University Law Center and his master of public administration from Indiana University.

We have written statements from each of these witnesses and I ask unanimous consent that they be submitted into the record in their entirety.

Again, I remind you folks, please comply with the 5-minute rule as we are advancing late in the afternoon. Ms. Montgomery, we will begin with you.

I recognize the gentleman from California.

Mr. BERMAN. I unfortunately am going to have to leave and I—we have the testimony. I have staff here. I am interested in what the witnesses have to say and we will refer to their testimony.

I did want to make one point. A draft, sort of a preprint of a bill, was distributed with my name on it, I think, going along with this notion of changing the method of—overturning the court decision and changing the method of recordation, and I never consented to that. I think—I believe it was, I am sure—I hope it was inadvertent, but I just wanted to make clear I have some concerns about the legislation that was being circulated and did not ever authorize my name be placed on it as a co-sponsor.

Thank you, Mr. Chairman.

Mr. COBLE. Folks, this is a little irregular and a little informal. Howard, I have got to return a phone call. If you could, assume the chair and I will be back momentarily. Ms. Montgomery, if you will proceed.

STATEMENT OF SUSAN BARBIERI MONTGOMERY, ATTORNEY AT LAW, FOLEY, HOAG & ELIOT, LLP, ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Ms. MONTGOMERY. Thank you, Mr. Chairman. Before you go, as someone who is here for the first time, I thank you for calling me a new friend.

Mr. COBLE. You are indeed a new friend and I will be back.

Ms. MONTGOMERY. Although I am here for the first time, I as well as others may recall that this issue of security interest in intellectual property has been addressed in the past several times, usually in connection with only one of the Federal intellectual property statutes, and there has been a great deal of disagreement with those past proposals. It was for that reason that in 1993 the Business Law Section of the ABA and the Intellectual Property Law Section of the ABA together set up a joint task force to work together to represent the different attorneys practicing in those sections and the different clients and industries represented by those sections, to come up with an approach that would not be controversial and would meet the needs of the different constituencies.

I am here today as a co-chair of that joint task force and I am joined by my co-chair, Larry Engel, who is also here, and we are here to talk to you about the result of the efforts since 1993 of that joint task force. I do want to talk to you about the proposal we have which we see as a solution, but I think that I better first spend a little bit of time describing what we perceive as a problem and what was presented to this joint task force as a problem, and what we are trying to address and provide a solution for in the Federal Intellectual Property Security Act, which is one of drafts that you have seen.

Basically it is a problem that seems to have two types of roots in the existing law. There is a lack of clarity in the Federal statutes with respect to the handling of security interests in intellectual property and it is important here to note the difference. I am not talking about assignments, and I am not talking about ownership. In fact, when the statutes were drafted, care was taken, and they are rather clear on those points, and it is for that reason that I also believe that those who are owners and are not interested in using their assets for lending purposes have less problem here.However, there is a lack of clarity and there is also a divergence in handling of these issues and that has led to various interpretations by the courts.

One case that has been talked about and will be talked about more is the *Peregrine* case, and while some will find not all of the *Peregrine* case controversial, certainly those who have unregistered copyrights are concerned about the fact that the case makes it no longer possible to use unregistered copyrights for perfected security interests.

And also that case, and the *Avalon* case that followed, has raised problems regarding proceeds from intellectual property that apply to all types of intellectual property patents, copyrights, and trademarks alike. This has led to a great deal of uncertainty. There is a lack of uniformity across the different types of intellectual property. Each one must be handled differently in the lending environment and there is a lack of sufficient information in an accessible system right now. It is not possible to find out as much as you would like to find out about ownership or those who might be claiming liens. There are also lookback periods and delays in the filing system that make information completely unavailable at crucial periods of time.

Now, this isn't a problem for every owner of intellectual property and I am not here to say that it is. Some owners of intellectual property do not use their assets and need not use their assets to raise funding, but for many, many owners of intellectual property, this is a problem. The uncertainty and the current complexity in the law means that for some types of intellectual property, and in particular if the collateral you are offering up is mixed intellectual property (if it is a combination of copyrights, trademarks, and patents), then no funding is available or devalued funding is available, and sometimes a lender will even insist on a transfer of ownership.

This insecurity is particularly acute in the development environment where there is, as you asked earlier, Chairman Coble, there is no specific identifiable work because it is a work in progress and it may change from being a trade secret to a copyright or patent. It is not identifiable at the very time when those who are working on it and using it would like to take an advantage, get some funding and use it as security, and it is not available.

Certainly this is a problem that has been reviewed by many courts and I have cited and quoted for you in our report a recent court decision noting the need for uniformity in asking for law reform in each of the Federal statutes.

What does our solution do? It introduces a mixed approach. It provides for a notice filing system and eliminates the lookback period. It includes a requirement for prompt filing and it encourages establishment of an electronic filing system and perhaps a single system.

I would welcome questions. I can see that I have run out of time much faster than I thought I would. I would like to address what I think are some misconceptions and misunderstandings that have been presented in some of the materials. I would welcome questions from you and I would also welcome the opportunity to work with this subcommittee, with different industries, and the owners of the different types of intellectual property so we can come up with a solution that works for those who do perceive a problem and that does not create unnecessary problems for those who perceive none.

[The prepared statement of Ms. Montgomery follows:]

PREPARED STATEMENT OF SUSAN BARBIERI MONTGOMERY, ATTORNEY AT LAW, FOLEY, HOAG & ELIOT, LLP, AND G. LARRY ENGEL, ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Chairman Coble, Members of the Subcommittee:

Thank you for the invitation to testify at today's oversight hearing on intellectual property security registration. The views we are expressing today represent those of the Section of Intellectual Property Law and the Section of Business Law of the American Bar Association. These views have not been approved by the House of Delegates or Board of Governors of the ABA, and, accordingly, should not be construed as representing the position of the Association as a whole.

We understand that one of the matters the Subcommittee will be examining this afternoon is a legislative proposal prepared and presented to you for your consideration by our two Sections of the ABA, a copy of which is attached. As co-chairs of a Joint Task Force that worked on behalf of the two Sections to develop this proposal, we appreciate the opportunity to appear before the Subcommittee to explain and speak on behalf of our proposal. We believe that this is an important law reform effort to facilitate secured financing, to clarify legal issues adversely impacting commerce, and to ensure uniform treatment of intellectual property security consistent with reasonable business practices.

Our names are G. Larry Engel and Susan Barbieri Montgomery. In addition to co-chairing the Joint Task Force, Larry Engel is also the Chair of the ABA Business Law Section's Ad Hoc Committee on Security Interests in Intellectual Property, and speaks for the Business Law Section from the perspective of commercial lawyers and clients. Business Law Section participants on the Task Force represent a wide range of Committees, such as the Uniform Commercial Code Committee, the Business Bankruptcy Committee, the Commercial Financial Services Committee, the Banking Committee, the Corporate Counsel Committee, the Corporate Practice Committee, the Cyberspace Law Committee and others. Susan Barbieri Montgomery is the chair of the ABA Intellectual Property Law Section's Committee 457, and she speaks for the Intellectual Property Section from the perspective of intellectual property lawyers and their clients, including those whose practices focus on patents, trademarks, copyrights, computer chip mask works, and trade secrets. The diverse perspectives and experiences of the two areas of specialty have been synthesized in the ABA proposal.

In order to facilitate the financing on desirable terms that is needed to fund the operations and growth of U.S. businesses, it is necessary for many businesses to borrow on a secured basis, often using all of their assets as collateral. In the technology development environment, intellectual property collateral may also be needed to secure other types of performance obligations. For technology companies, a bundle of intellectual property may be the only available significant asset. Increasingly, for all types of American businesses, intellectual property assets are a valuable part of any collateral package.

In order to satisfy the needs of commercial lenders and other parties, a security interest in collateral must be capable of certain and cost-effective "perfection," so that the lender can establish its priority over subsequent lenders and the lender's security interest is not avoidable in the event of the bankruptcy of the borrower. *See* Bankruptcy Code §§544, 547. It is also necessary for a financier to be able to quickly and inexpensively verify the borrower's ownership and the priority of the security interest in comparison to any competing interests and transfers. Unfortunately, in the case of intellectual property collateral, the certainty and predictability required for such financing have been impaired by varying treatment in the different Federal statutes and by several controversial court decisions (discussed below). These problems are addressed and, we believe, resolved by the proposed legislation we have submitted. In addition, related reforms in the ABA proposal facilitate financing by implementing better practices involving notice filings, availability of records and other process changes (*e.g.* elimination of the uncertainty created by current "lookback" periods for recording of intellectual property transfers) to expedite transactions.

While parallel law reform efforts have been undertaken at the State level with respect to security interests and notice filings pursuant to the Uniform Commercial Code, the Federal intellectual property laws and filing processes have not evolved in a consistent manner. This difference exists in part because the Federal intellectual property laws were designed to focus on absolute transfers of ownership, rather than upon security interests. These issues have been studied for years by the Joint Task Force, but the need for reform has accelerated because of financing realities of increasing importance for all types of businesses, whether or not considered technology companies. Every company has trademarks and trade secrets, and most now also have copyrights, although the latter are most commonly not registered. Many companies also have interests in patents and other types of intellectual property.

While intellectual property is normally addressed as a part of a collateral package that includes the borrower's other assets, a problem arising with respect to the intellectual property collateral can prejudice the quality and value of the other types of conventional collateral. For example, even a lender who is primarily lending against the borrower's accounts receivables and inventory can be severely prejudiced if the lender's security interest in intellectual property is problematic. Consider, for example, the fate of a lender whose inventory collateral is copyrighted or trademarked, if the lender cannot maintain an effective security interest in such intellectual property. This is the principal focus of the Commercial Finance Association's "quick fix" for copyrights. While the CFA proposal appropriately addresses the copyright part of the problem, that narrow copyright solution may not eliminate some broader problems created by cases like *Avalon Software*, discussed below, which affect patents and trademarks as well.

Similarly, the lender can be disappointed if the revenue from the licensing or sale of the borrower's products is deemed to be avoidable "proceeds" of an unperfected security interest in the underlying intellectual property. As noted below, some controversial court decisions would make it legally impossible to preserve in the borrower's bankruptcy a security interest in the borrower's unregistered copyrights and their "proceeds". Such courts have defined "proceeds" to include certain ordinary revenue from disposition of the products in the borrower's inventory (*e.g.*, revenue from the sale of hardware products is treated in part as proceeds of the unregistered copyrights in software or licenses included with the products).

These problems frustrate financing and create unnecessary risks, which decrease the availability of cost-effective financing for companies on desirable terms. Lenders (and other secured parties to technology transactions) are often either hesitant to extend credit secured by intellectual property assets or they devalue the asset to reflect the uncertainty and risk associated with this type of collateral. This problem is especially serious for software companies, whose unregistered copyrights and license revenue raise the most difficult issues under the controversial court decisions. However, since the Supreme Court has confirmed that copyrights apply to marketing materials including product packaging (e.g. shampoo labels), almost every business has unregistered copyrights at issue. Under the controversial bankruptcy court decisions described below, the lenders risk the loss of the value allocated by the bankruptcy court to at least their copyright collateral and its proceeds. Because such collateral is typically interdependent and integrated with other collateral, such bankruptcy allocations between perfected collateral and avoidable collateral impose unnecessary litigation risks and uncertainties.

As one court recently observed in invalidating a trademark security interest that was not perfected under the applicable State version of the Uniform Commercial Code,

> It is, of course, unfortunate that the trademark statute is sufficiently vague to require judicial interpretation. This produced the understandable mistake made here. Security interests in patents present the same difficulty. . . . Not even the copyright statute is totally consistent with the Uniform Commercial Code. *All three statutes should be amended to place them in better harmony with the Code*. . . . (emphasis added).

In re Together Development Corp., 227 B.R. 439, 442 (Bankr. D. Mass. 1998).

CONTROVERSIAL COURT DECISIONS IMPACTING SECURITY INTERESTS

The Federal copyright, patent and trademark statutes provide systems for recording ownership and transfers of interests in the different types of Federal intellectual property. Over many years of continuous law reform efforts, the Uniform Commercial Code ("UCC") has created a cost-effective and uniform system of "perfecting" (and establishing priority among) security interests in most types of assets by means of a simple notice filing. Under any reasonable interpretation of the existing law, this system governs at least security interests in trade secrets and state trademarks and their associated "goodwill." Most experts contend that the UCC also governs the perfection of security interests in Federal trademarks and patents, consistent with all but one of the relevant court precedents, because those Federal laws deal with transfers of ownership, as opposed to security interests. *See, e.g.*, (trademarks) *In re Roman Cleanser Co.*, 802 F.2d 207 (6th Cir. 1986); *In re 1992 Z Inc.*, 137 B.R. 778 (Bankr. C.D. Cal. 1992); *In re Topsy's Shoppes, Inc. of Kansas*, 131 B.R. 886 (D. Kan. 1991); *In re Chattanooga Choo-Choo Co.*, 98 B.R. 792 (Bankr. E.D. Tenn. 1989); *In re TR–3 Industries*, 41 B.R. 128 (Bankr. C.D. Cal. 1984); (patents) *City Bank and Trust Co.* v. *Otto Fabric, Inc.*, 83 B.R. 780 (D. Kan. 1988); *Chesapeake Fiber Packaging Corp.* v. *Sebro Packaging Corp.*, 143 B.R. 360 (D. Md. 1992); *In re Transportation Design and Technology, Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985); *Holt* v. *United States*, 73–2 U.S.T.C. ¶9680 (5th Cir. 1973). The core of the problem addressed by the proposed legislation arises from several related, controversial court decisions, commencing with *In re Peregine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990). *See In re AEG Acquisition Corp.*, 161 B.R. 50 (9th Cir. BAP 1993); *In re Avalon Software, Inc.*, 209 B.R. 517 (Bankr.D. Ariz. 1997); *The Clorox Co.* v. *Chemical Bank*, 40 U.S.P.Q. 2d 1098 (1996).

Clearly, in the modern world the borrower's products will often involve an interaction among all types of intellectual property, such as, for example, a patented hardware product with a valuable trademark that operates using software involving registered or unregistered copyrights and that is produced with the use of valuable trade secrets. If one part of that lender's security interest in that integrated bundle of rights (*e.g.* the copyrights) is unperfected and therefore becomes avoidable in bankruptcy, then a wholly artificial allocation of value must occur among the functionally inseparable components of a unitary product and its proceeds.

Indeed, even a pure software product may create complex value allocation problems, since the software product typically involves far more than copyrights on the source and object codes, but can also involve trade secrets and patents, as well as trademarks. There is no clear, consistent system for establishing the priority of the secured party's interest in a technology product or process that combines different types of intellectual property. Because many financiers margin the amount of credit that they extend to their borrowers against the reliable value of their perfected and nonavoidable collateral, uncertainty about intellectual property collateral unnecessarily reduces the credit available to borrowers. This problem is particularly acute in the technology development environment, where the developer faces great difficulty in obtaining credit until its technology is sufficiently developed to permit registration under the Federal systems.

The least controversial of several debated holdings of these controversial cases is that a trustee in bankruptcy can avoid a security interest in *registered* copyrights, if the secured party fails to record the security interest in the Copyright Office. *See Bankruptcy Code §§544, 547*. At least one court and many (but not all) experts would also agree that existing law creates that same result for *unregistered* copyrights, although this interpretation means that it is legally impossible to perfect a security interest in *unregistered* copyrights. Thus, in many cases (especially involving software) friction arises between lenders and borrowers over whether to depart from the borrower's rational industry practice of not registering many types of copyrightable material that the borrower owns.

However, even when the copyright owner elects to register its copyrights in the Copyright Office so that it is possible for the lender to perfect its security interest, the result is imperfect. In many cases the borrower regularly creates derivative works that upgrade the copyrighted work, which derivative works would, therefore, require frequent and burdensome supplemental registrations and security filings for the protection of the lender under current copyright law. Even where such supplemental registrations and security filings occur, the lender may still be at risk as a result of the 90-day preference exposure under Bankruptcy Code §547.

An even more controversial decision in those disputed court cases is that certain revenue from the borrower's products constitutes "proceeds" of intellectual property. For example, license royalty payments on software operating a product sold by the buyer could be deemed "proceeds" of a copyright. If the security interest in the copyright is avoidable in bankruptcy, then so is the security interest in such proceeds. This is disputed by most legal experts, who would focus instead on the UCC status of such revenue as, for example, an "account" or "general intangible" (*see* UCC §9106) or as proceeds of the "inventory" being sold by the borrower (*see* UCC §§9306, 9109). There are some supporting court decisions for that UCC interpretation. *See, e.g., Broadcast Music, Inc.* v. *Hirsch*, 104 F.3d 1163 (9th Cir. 1997).

In any event, unless the lender's only collateral is a bare copyright license by itself (an increasingly smaller percentage of the total transactions in many industries), this "proceeds" issue creates uncertainty and allocation disputes. In many transactions, the revenue at issue arises from a single price paid by the customer for a combination of a trademarked or patented hardware product and licenses of various kinds of intellectual property, including software copyrights. Indeed, as a result of the Supreme Court's confirmation of copyright protection for shampoo labels as recognized in *Quality King Distributors, Inc.* v. *L'anza Research International, Inc.*, 523 U.S. 135, 118 S.Ct. 1125, 140 L.Ed. 2d 254 (1998), a portion of the accounts receivable from the sale of even "low tech" inventory could be argued under the disputed *Peregrine* theory to be proceeds of a copyright.

However, the ultimate intellectual property "heresy" is evidenced by the bankruptcy court's decision in *In re Avalon Software, Inc.*, where the court appeared (without citing authority or offering an explanation) to "deperfect" and avoid what experts would have considered to be nonavoidable perfected security interests in trademarks, trade secrets, and software related licenses, contracts, and inventory (*e.g*, user manuals, documentation, etc.). In effect, because the lender was unable to perfect the security interest in the bankrupt software company's copyrights, the lender lost the core of its tangible and intangible software-related collateral, even though the lender's interest in everything but the copyright was properly perfected under the UCC. In effect, the Court dodged the difficult allocation issue for splitting the value of the debtor's assets between (1) the software-related copyrights, and (2) everything else, by treating all of the software related assets as if they were somehow merged into the unperfected copyrights and, therefore, as also avoidable by reason of their association with the avoidable copyright security interest. The fact that the unprecedented *Avalon* theory is widely deemed to be incorrect by legal experts does not prevent that theory from now being regularly argued by trustees in bankruptcy across the country. While the *Avalon* aberration may be extreme, it illustrates why reform is essential.

We perceive no compelling policy or legal reason for making it legally impossible to perfect security interests in unregistered copyrights, or even in making it impractical to perfect security interests in registered copyrights. While some parties still attempt to address these problems by using documentation which is in form an absolute assignment of rights to the borrower's intellectual property (but is intended to be a security interest), the results can be very disappointing. *See, e.g., The Clorox Co.* v. *Chemical Bank*, 40 U.S.P.Q. 2d 1098 (1996) (transfer of rights in trademarks prior to actual registration and use is void where the secured creditor describes the transfer as an assignment rather than a security interest); *Haymaker Sports Inc.* v. *Twain*, 581 F.2d 257, 261 (CCPA 1978) (voiding an assignment under the "assignment in gross" doctrine). Proper treatment of security interests should eliminate the need to accept the risk of such results.

OTHER DESIRABLE REFORMS

The desire for certainty and uniformity with respect to the filing requirements for security interests in intellectual property goes far beyond borrowers and lenders. Clearly, many parties to commercial transactions besides traditional lenders have an interest in obtaining security interests to secure obligations of their counter-parties, including because they wish to receive the increased protections available to secured creditors in the event of the counterparty's bankruptcy. Moreover, licensees, licensors, purchasers, venture partners and other parties to strategic transactions also have an interest in being able to determine the nature and extent of competing security interests, encumbrances and other interests in intellectual property. While some transactions may only involve one type of intellectual property, increasingly multiple intellectual property rights are involved in transactions, so that lenders and others have become accustomed to searching in both state UCC filing offices and Federal registries. The burden of UCC filing and searching is not as significant as one might expect, since intellectual property is classified as "general intangibles" under UCC § 9106, which need only be filed in one state under UCC § 9103, not in every state where the borrower does business.

The current search process is, however, complicated by the existing "lookback" provisions under Federal intellectual property laws. These provisions require parties desiring timely closing of their transactions to assume the risk of the existence of a preceding transfer of intellectual property rights that is not yet submitted for recordation. Other complications for the due diligence process of evaluating title to intellectual property collateral under current law include varying requirements and documentation among the copyright, patent and trademark laws, as well as gaps in the records.

Given the present uncertainties, the current practice of many lenders and secured parties is to undertake dual filings: one UCC filing in the applicable state system (UCC §§ 9103, 9401), together with filings in the Patent & Trademark Office for patents and trademarks and in the Copyright Office for registered copyrights and mask works. (As noted above, there is no present ability to file a security interest in the Copyright Office for unregistered copyrights, and software developers and various other copyright owners are reluctant for costs or competitive business reasons to register all their copyrights.) The ABA proposal is consistent with that practice, with the state UCC filing perfecting the lender's security interests (and making it nonavoidable by the trustee in bankruptcy), while the Federal filing establishes priority as compared to subsequent transfers of ownership interests in the applicable Federal intellectual property.

State UCC notice filings to perfect security interests are preferred not just by lenders but by many secured parties for various reasons, including:

1. The UCC permits "floating" liens on all intellectual property of the owner, whether now existing or hereafter arising. This floating lien does not exist under Federal intellectual property law, thus, for example, creating the copyright burden described above with respect to the requirement of separate filings for each new derivative work.
2. Instead of the separate filing requirements under Federal law for each new copyright, trademark or patent, UCC notice filings can be done by general descriptions of the covered collateral, even in advance of the closing of the transaction (e.g., a security interest in all general intangibles, including all patents and applications of the debtor, now existing or hereafter arising.)
3. Instead of indexes by registration number in the Copyright Office, UCC searches can be conducted in the applicable state by reference to the debtor-owner's name.
4. After decades of encouragement from commercial users, the UCC filing and search reporting systems are comparatively quick and cost effective to use, without a transaction-delaying "look back period" as exists under the Federal intellectual property laws.

The law reform contemplated by the ABA proposal introduces many of these desirable features in the proposed Federal filing system for security interests in intellectual property..

THE PROPOSED LEGISLATION IMPLEMENTS ABA JOINT TASK FORCE RECOMMENDED REFORMS

After years of study and consultation with many client constituents of the ABA Business Law Section and Intellectual Property Law Sections, the ABA Joint Task Force has made the following recommendations:

- *The establishment of a "Mixed Approach" of Federal and state law to govern recordation of security interests in intellectual property.* Under this mixed approach, recordation in the relevant Federal agency of security interests in intellectual property governed by federal law would establish the secured party's priority with respect to subsequent bona fide purchasers for value and all other subsequent transferees of ownership interests, excepting only security interests. Recordation of security interests in all intellectual property in the relevant state agency under Article 9 of the Uniform Commercial Code would perfect the security interest and establish priority as against other secured parties and lien creditors.
- *Provision for utilization of the same type of notice filing in the federal agencies with respect to security interests as in state agencies under the Uniform Commercial Code.* This would be accomplished by amendment of the patent, trademark, copyright and mask work laws and rules to permit recordation in the respective federal agencies of notices of security interests with respect to debtors, without requiring specific identification of the properties securing the debt and without requiring recordation of the security agreement itself. Substantially the same form of notice filing as is currently employed under the Uniform Commercial Code could be utilized in the federal filing,
- *Permitting the notice filing of security interests to apply to "after-acquired" intellectual property of debtors.*
- *Making the Federal agency records concerning title to and security interests in intellectual property more useful by eliminating or substantially reducing the period for recordation of documents.* This would be accomplished by amendment of the patent, trademark, copyright and mask work laws to substantially reduce the "lookback" periods for recordation of documents concerning title to and security interests in intellectual property, and requiring prompt recording and indexing by the federal agencies.
- *Encouraging the establishment of an electronic filing system.* This would reduce the agencies' burden of handling and recording security interests and fa-

cilitate the prompt and cost-effective availability of records for interested parties.

The ABA proposal embodies the approach recommended by the ABA's Section of Intellectual Property Law and Section of Business Law to implement these reforms in a manner that we hope and believe is consistent with the needs of all relevant constituencies. We would welcome the opportunity to work with you and the Subcommittee staff in further developing and advancing these proposals. Thank you for your interest and consideration.

Mr. COBLE. I thank my new friend. Ms. Montgomery, I am a frustrated geographer. Is the Rhode Island School of Design in Providence?

Ms. MONTGOMERY. Yes, it is.

Mr. COBLE. Mr. Johnson, I was told that one of the members of this panel had a connection to my congressional district. Are you that person?

Mr. JOHNSON. I am, Mr. Chairman.

Mr. COBLE. Good to know you. High Point is the town?

Mr. JOHNSON. That is correct. Although I was born and brought up in the north, I spent 18 years in your fair State, and it slowed down my speech pattern, so I hope you will cut me a little slack.

Mr. COBLE. I will be patient with that. For the benefit of the uninformed—Mr. Johnson knows this, I think Mr. Kirk knows this—High Point is recognized as the furniture capital of the world. We used to call it the furniture capital of the South. It is now the furniture capital of the world. Good to have you with us, Mr. Johnson.

STATEMENT OF CHARLES G. JOHNSON, PRESIDENT AND CEO, ALLSTATE FINANCIAL CORPORATION, ON BEHALF OF COMMERCIAL FINANCE ASSOCIATION

Mr. JOHNSON. Thank you, Mr. Chairman and other members of the subcommittee. My name is Charlie Johnson and I am President and CEO of Allstate Financial Corporation. But I am here today in my role as First Vice President of the Commercial Finance Association, or CFA, which is the trade group for the asset-based financial services industry.

CFA members provide asset-based commercial financing and factoring products and services to small- and medium-sized businesses. Some of our larger members include Nationsbank, Bank of America, GE Capital, Fleet Capital, and Citigroup.

In 1997, the over 300 CFA member companies extended approximately $205 billion in credit to businesses throughout the United States. I must admit on this subject, as fundamental to our business as the perfection of security interests, I find it a bit strange that I am addressing the Courts and Intellectual Property Subcommittee and not the Commercial Law Subcommittee or the Banking Committee.

However, the impetus for today's hearing has shown in recent holdings *In re Peregrine* and *In re Avalon* have forced bankers to act like copyright lawyers and it has forced the U.S. Copyright Office into the business of secured financing. Unfortunately, these are unfamiliar and inefficient roles that neither the banking industry nor the Copyright Office desired or, under current law, is well-suited to fulfill. As a result, borrowers and their lenders have—especially in the software industry—had to incur significant costs, delay, and administrative burden or in, some situations, have had to forego otherwise attractive financing opportunities altogether.

For many reasons that are elaborated in my written testimony, CFA strongly believes that the current law governing the perfection of security interests and copyrights badly needs reworking. CFA welcomes the opportunity to work with the groups present here today and others to devise a comprehensive Federal filing system for all intellectual property.

However, as today's testimony reveals, there is still no agreement on how to create such a filing system nor when such a filing system could become fully functional. In the meantime, lenders and borrowers are left struggling with the current cumbersome system, which the Copyright Office in its March 18 memo to the chairman of this subcommittee, described as causing, quote, "significant problems with the financing of copyrighted materials."

In the interim, CFA believes that it would be very beneficial to borrowers and lenders for Congress to pass a narrowly-focused, narrowly-targeted legislation which could provide immediate relief for borrowers and lenders alike.

The Copyright Office would appear to agree with CFA's approach not only in their March 18 memo, but I believe earlier today in the Honorable Ms. Peters' remarks, she mentioned that it might make sense to recognize the perfection of a security interest in copyrights at the State level for the purpose of allocating rights among lien creditors.

The CFA draft bill that has been submitted to the subcommittee would accomplish this limited goal through an amendment to the Copyright Act. It would allow a lender, through a UCC filing, to perfect a security interest in both copyrighted and copyrightable material. Only the rights of a holder of a security interest and lien creditors would be affected. It would not affect the rights of an outright transferee of a copyright or the interest in a copyright such as a bona fide purchaser or exclusive licensee. These persons would continue to take free and clear of any security interest filed only at the State level under the UCC.

It is important to stress that CFA's proposal would not require third parties to conduct a 50-State search to ascertain whether there is a security interest that exists in a copyright. If a third party were to be a bona fide purchaser or licensee, it would need only to look for filing at the Copyright Office, for a security interest in a copyright is not registered—if it is not registered there, that person would take free and clear of the security interest. If a third party did elect to conduct a search under the UCC for a recorded security interest, they would only need to look in one State, that namely being the State where the debtor is located.

In the end, the CFA bill would simply allow a secured lender who has loaned money to a business secured by copyrighted or copyrightable material or assets of the business to establish a priority over a bankruptcy trustee through the filing under the UCC.

The same can be done with patents and trademarks. In this way, in the unfortunate event that a business borrower seeks bankruptcy protection and the copyright assets are sold, the lender who supported the business by extending it credit would be paid ahead of the bankruptcy trustee, as intended by commercial and bankruptcy law. On behalf of CFA, I would like to thank the chairman for holding this important hearing.

Mr. COBLE. I thank you, Mr. Johnson.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF CHARLES G. JOHNSON, PRESIDENT AND CEO, ALLSTATE FINANCIAL CORPORATION, ON BEHALF OF COMMERCIAL FINANCE ASSOCIATION

INTRODUCTION

Chairman Coble, members of the Subcommittee, my name is Charlie Johnson. I am the President and CEO of Allstate Financial Corporation. Allstate Financial, which is located in Virginia, provides asset-based commercial lending products and financial services to a variety of businesses. I am present today in my capacity as First Vice President of the Commercial Finance Association or CFA, the trade group for the asset-based financial services industry. On behalf of all CFA members, I appreciate this opportunity to present to the Subcommittee the CFA's views on the problems and difficulties that have arisen in the area of secured financing involving copyrights as a result of recent judicial decisions in the Ninth Circuit. These cases, most notably *In re Peregrine Entertainment* and *In re Avalon Software Inc.*, have held that the Copyright Act pre-empts the Uniform Commercial Code with respect to the perfection of security interests in both copyrighted works and copyrightable material which has not yet been registered in the Copyright Office.[1]

CFA also appreciates the opportunity to address legislative approaches, one from the Commercial Finance Association and another from the American Bar Association, that have been offered to the Subcommittee to address the problems resulting from *Peregrine* and *Avalon*. I also want emphasize that in addition to addressing the current difficulties faced by lenders and borrowers engaged in secured financing transactions involving valuable copyrights, both the comprehensive ABA bill and the narrowly targeted copyright specific CFA bill have an equally important goal. This goal is to bring the law regarding the treatment of security interests in copyrights in bankruptcy proceedings into harmony with similar laws governing security interests in patents and trademarks.

THE COMMERCIAL FINANCE ASSOCIATION AND ASSET-BASED LENDING

The Commercial Finance Association is the trade group for the asset-based lending and factoring industries. Our association consists of more than 300 members, including money center banks, regional banks, independent finance companies, and commercial lenders that are publicly held or owned by industrial companies and foreign banks. Some of our larger members are Citigroup, Nationsbank/Bank of America, GE Capital, and Fleet Capital. Our member institutions are located nationwide and around the world.

CFA members provide asset-based commercial financing and factoring products and services to small and medium-sized businesses at the local, regional, national, and international level. In 1997, CFA members extended approximately $205 billion in credit to small and medium-sized businesses throughout the United States. These funds supported more than $2 trillion in economic activity and millions of jobs.

[1] *In re Peregrine Entertainment Ltd.* 116 B.R. 194 (C.D. Cal. 1990). In *Peregrine*, a film distributor granted a lender a security interest in its inventory, which included film copyrights. The lender filed financing statements with the state under the Uniform Commercial Code. After the borrower filed for bankruptcy, the trustee challenged the perfection of the security interest. The California bankruptcy court held that the Copyright Act of 1976 establishes a comprehensive national system for recording transfers of copyright interests, and, therefore that federal law broadly pre-empts state law regarding the manner of perfection of security interests in copyrights themselves and any proceeds thereof, including accounts receivable generated through licenses of copyrights. Since the lender had not filed its interest with the Copyright Office, it lost its security interest in the films and the licensing revenues they generated.

In re Avalon Software, Inc. 209 B.R. 517 (Bankr. D.Ariz. 1997). In *Avalon*, a lender obtained a security interest in all the assets of a software developer, including copyrighted software and software in process of development. The lender filed financing statements with the state under the UCC. In bankruptcy, the trustee challenged the perfection of the security interest. The Arizona bankruptcy court, building on *Peregrine*, re-affirmed that the only method for perfecting a security interest in a copyrighted work was to file at the Copyright Office, and then extended this requirement to copyrightable works. The Court found that a work entitled to be registered with the Copyright Office does not become something different because it is not registered. Thus, a security interest filing with the Copyright Office is still required to perfect a security interest in such work, and such security interest cannot be filed until the work has been registered.

Many small businesses depend on asset-based financing for working capital, and for some businesses, such financing is their only available option.

Asset-based loans are lines of credit that generally are secured by a "floating lien" on the borrower's assets. A floating lien usually covers all the borrower's assets including inventory, equipment, accounts receivables, general intangibles (which include intellectual property), after-acquired property and other valuable personal and real property.

In substantially all cases not involving collateral in the form of copyrights or copyrightable material, a security interest in a borrower's assets becomes perfected when notice of the security interest is properly filed under the Uniform Commercial Code. With respect to intangible assets, such as patents, trademarks, and accounts receivable, this involves filing a UCC–1 financing statement, describing the collateral, with the designated filing office(s) in the state where the borrower is located.

When a lender's security interest in the collateral of a borrower is perfected, the lender's interest is valid against the claims of third parties, as well as against the debtor. It is important to point out that the majority of priority contests occur in the context of bankruptcy proceedings where the priority contest pits a security interest holder against the debtor's trustee in bankruptcy or other security interest or lien holder.

It almost goes without saying that the more certain and predictable a lender's security interest in the borrower's collateral, the better the loan terms the borrower can obtain. Conversely, risks and uncertainties with respect to a lender's security interest will increase the costs to the borrower, or in some cases, even make credit unavailable.

THE PEREGRINE/AVALON PROBLEM

On a subject so fundamental and integral to the asset-based lending community such as the perfection of security interests, I must admit I find it a bit strange that I am addressing the Courts and Intellectual Property Subcommittee and not the Commercial Law Subcommittee or a Banking Subcommittee. Nonetheless, as the impetus for today's hearing has shown, *Peregrine* and *Avalon* have forced bankers to act like copyright lawyers, and it has forced the U.S. Copyright Office into the business of secured financing. Unfortunately, these are unfamiliar and inefficient roles that neither the banking industry or the Copyright Office desired, or, under current law, is well-suited to fulfill.

As an example of this inefficiency, in a March 18 memo from the U.S. Copyright Office to the Subcommittee on today's topic, the Copyright Office stated that "while recordation [of a security interest in a copyright] under the UCC takes place in about two days, recordation in the Copyright Office can take several months. Much of the difference in time is attributable to the fundamentally different nature of the two systems." This means that anyone—a lender, a purchaser, or licensee—about to acquire an interest in a copyright will be forced to take added measures to try to determine if a security interest in that particular copyright already exists.

Another significant problem facing lenders and borrowers in the copyright field is directly traceable to the *Avalon* decision which held that under federal law *copyrightable* material (as distinguished from already *copyrighted* material) must first be registered in the Copyright Office before a security interest in such material can be perfected. This has greatly increased the risks, and thus costs, in using creative works in process as collateral for loans, and is a particularly worrisome problem for lenders who finance software developers. It also complicates film industry financings where a film is not typically registered in the Copyright Office until the film is ready for release. As a leading commentator on secured transactions, Barkley Clark, has noted, "This is a big problem with the federal copyright statute, it does not appear to allow after acquired property clauses. In this respect, it is much less flexible than Article 9 of the UCC."[2]

There are also other fundamental differences between the state UCC filing system and the federal Copyright Office system that impede efficient and cost-effective commercial financing when copyrights comprise the collateral. In contrast to UCC filings against intangibles, which are typically recorded in one location under the name of the debtor, a filing with the Copyright Office is made under the name or registration number of the copyrighted work. Consequently, searches in the Copyright Office for existing filings require that the searching party know the name or number of the registered work, and separate filings must be made for each individual work pledged as collateral.

[2] Clark, "The Law of Secured Transactions under the UCC (1998 Cumulative Supplement No. 2, Sec. 1.08 (1) (e), page SI–29.

Furthermore, the Copyright Office rules for establishing the priority of competing security interests in copyrights are much less certain than those found in the UCC. It is essential that lenders know, based upon public records, their relative priority in collateral at the time a transaction closes. The UCC priority rule is simple—the first to file (or otherwise perfect) has priority. Under this first to file system, a lender can be certain that its loan will be secured and prior to others by properly filing a UCC–1 form and then searching to see that no other party is senior.

No such certainty exists under the Copyright Act's first to sign rule. Section 205(c) provides that the first to sign a security interest has priority, provided it is recorded within thirty days if signed within the U.S., or within 60 days if signed outside of the U.S. Thus, a lender who filed first with the Copyright Office could still lose priority to a lender that obtained an earlier signed document.

In addition, another problem exists concerning the enforcement of security interests in copyrights. *Peregrine* focused entirely on the filing issue without addressing the extent to which the UCC may nevertheless govern other aspects of security interests, such as enforcement. Earlier case law held that the federal statute had no role to play in foreclosures of security interests in copyrights.[3] Thus the foreclosure rules of the UCC should still govern in this important area.

Presently, for a lender to ensure perfection under federal law, the lender must take the following steps. (1) conduct a thorough audit of all the borrower's copyrights and copyrightable material, (2) require the borrower to register any copyrightable material, (3) enter into a security agreement that identifies each of the copyrights by title or registration number, (4) record the security agreement with the Copyright Office, (5) establish a reporting and monitoring process with respect to the borrower's existing and after-acquired copyrights, (6) require the borrower to register all after-acquired copyrights, and (7) record any additional security interests with the Copyright Office as additional copyrights (including derivative works, enhancements and modifications, are added to the collateral.

ADDRESSING THE CURRENT LEGAL SITUATION

CFA strongly believes that the current law governing the perfection of security interests in copyrights is negatively impacting secured financing and badly needs reworking. Recording security interests in the Copyright Office does not facilitate financial transactions. As loans and business acquisitions are often made on very tight timetable, timely access to filing information about security interests and liens is vital to the free flow of commercial loans. A search of UCC filings can be performed quickly while a search at the U.S. Copyright Office can be time-consuming and costly, and fail to reveal security interests filed months previously. Nonetheless, CFA does not disagree with the *Peregrine* holding that federal law could pre-empt state law with respect to recording security interests in copyrights. In fact, the reasoning of *Peregrine* seems to highlight the need for a comprehensive federal recording statute governing all types of intellectual property including copyrights, patents and trademarks.

However, as the witnesses at today's hearing have indicated, and CFA representatives have ascertained from various meetings and consultations with members of the lending and copyright communities, and related federal agencies, there is no common agreement on how to devise and facilitate such a federal system. More so, there is no real indication when and if such a system could become functional. Unfortunately, until such a system can be constructed, we are left struggling with the current cumbersome situation regarding the perfection of security interests in copyrights—a situation that the Copyright Office, again in its March 18 memo to the Chairman of this Subcommittee, described as causing "significant problems with the financing of copyrighted material . . . ."

THE CFA AND ABA PROPOSALS

CFA welcomes the opportunity to work with the groups present here today and others to formulate a comprehensive federal filing system. However, in the interim, CFA believes that it would be highly beneficial to borrowers and lenders, especially in software related industries, for Congress to pass narrowly targeted copyright specific legislation which would provide immediate relief to the lending community while at the same time having a negligible effect on the copyright community. The Copyright Office would appear to agree with this approach. In the Copyright Office's above-mentioned March 18 memo to the Subcommittee on this subject, the memo concluded with the statement; "Before taking on comprehensive reform, solving the

[3] See *Republic Pictures Corp.* v. *Security-First National Bank of Los Angeles*, 197 F2d 767 (9th Cir. 1952).

immediate needs of the financing community by allowing the perfection of a security interest in copyrighted material through a UCC filing seems desirable."

Accordingly, the CFA bill submitted to the Subcommittee would accomplish this limited, yet very beneficial, goal. It would amend the Copyright Act to allow a lender, through a UCC filing, to perfect a security interest in both copyrighted and copyrightable material, thereby enabling the secured lender to prevail over a trustee in bankruptcy or other lien creditor. Such a narrow amendment would only affect the rights of holders of security interests and lien creditors; it would not affect the rights of an outright transferee of a copyright or an interest in a copyright, such as a *bona fide* purchaser or licensee, who would continue to take free and clear of any security interest filed only at the state level under the UCC.

This limited approach to the application of the UCC is also a fundamental component of the ABA draft legislation which would apply it to all intellectual property. While CFA believes the copyright specific problems of *Peregrine* and *Avalon* can be addressed with a copyright specific solution, CFA applauds the ABA proposal for recognizing that to promote financing and development of intellectual property, the UCC should govern the creation, attachment, perfection, priority and enforcement of security interests, while federal law should govern the rights of a person other than a secured party or lien creditor who acquires any other right or interest in intellectual property. A person the ABA bill defines as a "transferee."

CFA can clearly see the merits of the comprehensive filing system which the ABA suggests will better accommodate the filing of security interests when they are recorded at the federal level against transferees. But for CFA members who on a daily basis are being forced to deal with the realities of *Peregrine* and *Avalon*, such comprehensive relief may be more than is needed for a *workable interim* solution to their problems. Most challenges to secured loan documentation come from trustees in bankruptcy, and it is in such situations where relief is needed now. Accordingly, in response to this limited need, the primary thrust of the CFA bill is to change the confusing and inefficient current law in the context of bankruptcy proceedings.

As to the merits of the limited CFA bill, the Copyright Office, in the March 18 memo to the Subcommittee, commented; "The draft proposal makes minimal changes to existing provisions in Title 17 regarding recordation of transfers and other documents that would not require the Copyright Office to change any of its existing procedures . . . The Office believes a minimal approach at this time has considerable advantages. It would give financial institutions immediate relief; it would allow the Copyright Office, which is just beginning to consider efficiencies for recordation of documents such as an electronic system to continue using its existing system, and it would not preclude subsequent consideration of more comprehensive reform."

Such a limited amendment will also result in copyrighted and copyrightable material receiving the same legal treatment afforded patents and trademarks under existing law. Under a substantial majority of the cased decided with respect to other types of intellectual property, it is clear that a secured lender which is properly perfected under the UCC will obtain priority over non-consensual creditors, such as a bankruptcy trustee and lien creditors.

Patents and trademarks are treated differently from copyrights under existing case law. While federal recordation remains necessary to protect security interests in patents and trademarks against bona fide purchasers, such recordation is not required to give the secured creditor priority over the patent or trademark owner's trustee in bankruptcy.[4] There is no good reason for treating security interests in copyrights differently from those in patents or trademarks. Accordingly, the CFA bill will harmonize the law as it applies to these common forms of intellectual property.

Finally, it is important to stress, that the enacting the CFA's legislative proposal would not require subsequent buyers, licensees, lenders, or other lien creditors to conduct a 50 state search to ascertain whether a security interest exists in a copy-

[4] For cases dealing with patents, see, *In re Transportation Design and Technology, Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985) (holding that a lender's security interest in patents filed only with the secretary of state under the UCC, and not with the U.S. Patent and Trademark Office, prevails against the claim of the debtor's trustee in bankruptcy) and *City Bank & Trust Co.* v. *Otto Fabric, Inc.*, 83 B.R. 780 (D. Kan. 1988) (holding that no federal filing is required to protect a security interest in patents against a trustee in bankruptcy). For cases dealing with trademarks, see, *In re TR-3 Indus.*, 41 B.R. 128 (Bankr. C.D. Cal. 1984) (holding that a bank's security interest in a trademark, filed with the secretary of state, prevailed over a trustee in bankruptcy's claim because the Lanham Act does not preempt state law) and *In re Roman Cleanser*, 43 B.R. 940 (Bankr. E.D. Mich. 1984) (holding that filing under the UCC is sufficient to perfect an interest in a trademark since the Lanham Act only contemplates federal registration of *outright* assignments, not collateral assignments (i.e., security interests)).

right. First, if the subsequent party is a bona fide purchaser or licensee, it would need only look for a filing with the Copyright Office. If a security interest in the copyright is not registered at the Copyright Office, the purchaser or licensee would take free and clear of the security interest. Second, if an outright transferee elected to conduct a search for UCC recorded security interests, the search would only need to be in one state, namely the state where the debtor is located.

REAL WORLD EXAMPLE OF THE PROBLEM OF PEREGRINE

I would now like to share with the Subcommittee a recent true-life example of the problems that lenders and borrowers are facing as a result of *Peregrine* and *Avalon*. A CFA member financial institution in Chicago recently desired to make a bridge loan to a software developer who had begun developing a software program. This software program was the developer's primary asset and constituted most of the collateral for the proposed loan. The bridge loan was to be the beginning of what both the lender and the software developer expected to be a significant business relationship.

The lender was advised that under *Avalon*, it could not perfect its security interest in the software program of the developer until the program was registered with the Copyright Office. It required several weeks for the lender to convince the developer to register the software and prepare the necessary papers. Both the lender and the developer were quite concerned that the confidential nature of the software's source code could be compromised by registering it in the Copyright Office. In addition, the lender was concerned that there might be insufficient code developed to justify filing in the Copyright Office. The lender was also troubled that it might need to update the registration at frequent intervals, and also update its security interest, to reflect changes in the program or to reflect new programs developed by the borrower.

In the end, because of *Peregrine* and *Avalon* the lender was forced to slow down the transaction and require the software developer to register its software program, something the developer did not want to do. The lender now has a significant obligation to monitor the developer's ongoing software development work to determine whether enhancements or modifications to the registered software require additional registrations and security interest filings with the Copyright Office. In the secured financing arena, such situations do not enhance relationships between borrowers and lenders or promote efficient financing transactions.

CONCLUDING REMARKS

On behalf of over 300 members institutions of the CFA, I want to thank the Chairman for holding this hearing on this important issue that greatly affects the asset-based lending industry. As a result of the fundamental differences and difficulties in perfecting a security interest under the Copyright Act as opposed to the UCC, borrowers and their lenders have had to incur significant cost, delay, and administrative burden, or in some situations, they have had to forgo otherwise attractive financing opportunities altogether. As the software and related information technology industries continue to grow at a dazzling pace, the problems associated with financing copyrighted and copyrightable material under current federal law will only increasingly complicate or preclude credit extensions to such businesses.

CFA believes that its limited amendment to the Copyright Act offers a focused solution to a significant problem. It will allow a secured lender with a UCC perfected security interest to prevail over bankruptcy trustees and other secured parties when copyrighted and copyrightable material are offered as collateral. Such a modest change in the law to address a currently untenable situation will enable asset-based lenders to more efficiently and effectively fulfill their role in providing working capital to the small and medium sized businesses of America. It will also conform the law covering the treatment of copyright security interests in bankruptcy to the law covering patents and trademarks in that arena.

The CFA bill is not in derogation of any attempt to establish a comprehensive federal system for the recordation of security interests in intellectual property generally (including copyrights). It is an interim measure to correct an immediate problem that has adversely affected the secured financing of businesses that need to pledge copyrighted or copyrightable material as collateral, and as a measure to level the playing field for the treatment of all security interests in intellectual property in bankruptcy.

For all practical purposes, the CFA bill will simply allow a secured lender, who has loaned money to a business secured by copyrighted and copyrightable assets of the business, to establish priority over a bankruptcy trustee through a filing under the UCC—as can be done with patents and trademarks. This way, in the unfortunate event that the business borrower seeks bankruptcy protection and the copyright assets are sold, the lender, who supported the business by extending it credit, will be paid ahead of the bankruptcy trustee, as intended by commercial and bankruptcy law, and will not lose out because of the problems in perfecting a security interest under copyright law.

Mr. COBLE. Mr. Brennan.

STATEMENT OF LORIN BRENNAN, ESQ., EXECUTIVE DIRECTOR, GRAY MATTER, LLC, ON BEHALF OF THE AMERICAN FILM MARKETING ASSOCIATION

Mr. BRENNAN. Thank you, Mr. Chairman, I am here on behalf of the independent sector of the motion picture business. We have 140 companies engaged in producing independent pictures as well as 22 major financial institutions engaged in the business of copyright lending. I hear that some of my member institutions are the entertainment divisions of people who are also members of my colleagues' associations, so this will be interesting.

I am here to give our strongest opposition to the mixed filing system proposed in the ABA proposal and the CFA proposal. We opposed this in 1993 and we oppose it now because it would devastate lending in our business, raise costs to simply unacceptable levels. We represent the lenders who make loans exactly like were made in *Peregrine*. Our lenders find that the *Peregrine* decision actually affirmed their longstanding practice of making loans—and speaking as a lawyer who has actually made loans and documented and administered loans exactly like that in *Peregrine*, I would suggest that the lender in *Peregrine* got into trouble because it simply did not follow the ordinary standards of care by lenders who actually make these types of loans. That doesn't mean the system is perfect and we will propose some changes, but I would like to give you three basic ideas.

First, I wanted to explain why the mixed filing system will not accomplish its goals; second, why it will drive our cost to excessive levels; and third, a proposed solution.

First, why won't the mixed filing system accomplish its goals? Priority doesn't matter. The real issue is what happens when the secured creditor forecloses? Imagine this situation. Day one, lender files a mortgage of the copyright and files it only at the State level. One month later we have an exclusive licensee who records at the Federal level. One month later the secured creditor forecloses. Who owns the copyright?

Under State UCC, the lender becomes the transferee and owns the copyright free of the exclusive license; but under Federal law, the Federal transferee, since he recorded, federally owns the exclusive license. This is a direct conflict between State and Federal law. It cannot be resolved by any finessing of drafting. Only one can prevail.

Now, under both of the proposals we hear today, it looks like the idea is that the secured creditor would lose. That means a subsequent transferee would still prevail. But what does that do to the lender's collateral value? That means if the lender does not also record federally, it has no value. Mr. Chairman, it does no good for a bank to foreclose a loan on my car if my brother-in-law can still drive it. This statute will not eliminate at all the need to file and search federally. If Federal laws prevail, we must do that.

Number two, let's look at the cost. The problem with copyrighted works like motion pictures is we have very complicated chains of titles with many transfers. We have to look up a lengthy chain of title. I have included in my testimony an example of a motion picture and what it would take to finance.

Let's assume we were going to make a new movie based on the Terminator movies, Terminator 3. Now, there are prior works here. There are prior screenplays and two prior pictures. I have included a copy of a copyright report that we would see but I have excluded all the secured creditors. There are 94 transferees in the prior chain of title. We would have to locate them to see whether or not they have filed a security interest. Yes, we only have to search in one State but we don't know where they are. To find all 94 transferees in all 50 States would cost us more than $30,000. Once we then find the transferees, we have to order a search. That is 94 companies at $34 a search. Another $8,000.

Then we get the UCC–1s but the UCC–1s are not related to Terminator; they are related to a collage of people. We will have thousands of UCC–1s that we have to order copies from and to read for more money. That doesn't include the individuals. You can't search by individuals by country. So the cost here in the chart I have given you, it will cost us almost $60,000 to do what now costs us $250 under the current system and we can't even be sure we found everything.

That doesn't mean we think the current system is perfect. We have suggested we need to deal with after-acquired property and floating liens but they should be done in the Copyright Office. Copyrights are Federal works. They are supported federally. We need a Federal system. We have given a proposal in here of one way to do it in which we give constructive notice to documents filed in the Copyright Office against the transferee but we support the goal of improving the law in order to allow after-acquired properties and floating liens. Copyrights are national works. They can only be supported by a national register and therefore this needs to be done in the Copyright Office. We cannot live with the mixed systems proposed by either the ABA or CFA proposal. Thank you.

[The prepared statement of Mr. Brennan follows:]

PREPARED STATEMENT OF LORIN BRENNAN, ESQ., EXECUTIVE DIRECTOR, GRAY MATTER, LLC, ON BEHALF OF THE AMERICAN FILM MARKETING ASSOCIATION

INTRODUCTION

My name is Lorin Brennan. I am appearing as Special Counsel for AFMA (the American Film Marketing Association) and their Affiliated Financial Institutions (AFIs). AFMA is a trade association for 142 independent (non-studio) motion picture and television production and distribution companies. The AFIs, a division of AFMA, consist of 22 major banks and financial institutions. Neither I nor AFMA have received any federal grant, contract or subcontract in the current or preceding two fiscal years.

All of our member companies are familiar with secured copyright lending and the *Peregrine* decision (*In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990)). On their behalf, I am here to register our *strongest opposition* to the proposed Federal Intellectual Property Security Act (FIPSA). We oppose FISPA because:

- FIPSA will decimate the ability of motion picture producers to finance their productions, threatening tens of thousands of jobs.

- FIPSA will skyrocket the risks and legal uncertainties of secured copyright lending to ruinous levels.
- FIPSA will not and cannot accomplish its stated objectives, subjecting copyright borrowers and lenders to unacceptable risks for no benefits.

In my brief remarks I will identify the reasons why we have come to these conclusions. They are not new. We have opposed the FIPSA "mixed filing" scheme for years, and communicated our opposition to Congress, the Copyright Office and to the American Bar Association (ABA).

At the same time, we acknowledge that the current system of secured copyright financing needs improvement, especially for "floating liens" and "after-acquired property." We have advocated the need for constructive change to the Administration, the Copyright Office, and now Congress . We support the goal of FIPSA, but cannot in any way support its methods.

In have attached to this statement copies of some of our extensive work in this regard. They describe the many reasons why we cannot support the "mixed filing" system in FISPA. They also contain our suggestion for a workable solution.

WHY FIPSA WILL NOT WORK

Copyrights exist solely by reason of federal law. They are intangible assets, simultaneously everywhere, and highly divisible. They often have complex chains of title. As national assets, they are supported by a single, unified federal recording system in the Copyright Office. This system indexes transfers of copyright ownership against registered works.

Article 9 of the Uniform Commercial Code is state law. It deals with assets that are either located in any easily identifiable place, e.g. hard goods, or, in the case of intangibles, presumed to exist only at the location of the debtor. They rarely have complex chains of title. Article 9 indexes security interests against the debtor in numerous filing systems. As one commentator puts it: "Variations from state to state are legion; some are authorized by alternative versions of the [Uniform Commercial] Code itself; others are local frolics." (Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UCC, ¶2.12[1] (1994 Rev. Cum. Ed.).)

The collateral, focus and methodologies of the copyright system and the Article 9 system are marked opposites. Mixing them is a recipe for disaster.

1. FISPA Will Not Eliminate The Need To Make Dual Filings

The proponents of FIPSA complain that the decision in *Peregrine* requires a creditor loaning against a copyrighted work to search and file in the Copyright Office in addition to filing against the other assets under Article 9.

Whether or not this is a burden, FISPA will not eliminate it. To see why we need only ask: What happens when the secured lender forecloses? Consider the following (ignoring the 30–60 filing windows in the Copyright Act):

May 1: Copyright owner grants a security interest in a registered copyright to a Lender who records under UCC.

June 1: Copyright owner grants an exclusive license to a Licensee who records in Copyright Office.

July 1: Lender forecloses and becomes a transferee at foreclosure sale.

Who own the copyright, the Lender or the Licensee?

This example illustrates the conflict between the exclusive Licensee who records in the Copyright Office under federal law, and the Lender/Transferee at a foreclosure sale under state law. The conflict is not just in the priority schemes. It is in the basic system for transfer of ownership of the copyrighted work.

Under Article 9–105(d), a "debtor" includes a later owner of collateral, and Article 9–306(2) continues a security interest in collateral "notwithstanding sale, exchange or other disposition thereof" unless the lender releases. (Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UCC, ¶¶1.02[2], 2.11[1][a] (1994 Rev. Cum. Ed.).) Article 9–504(4) provides that "[w]hen collateral is disposed of by a secured party after default, the disposition transfers to the purchaser for value all of the debtor's rights therein, discharges the security interest under which it was made, and any security interest or lien subordinate thereto." In other words, per Article 9 the Lender takes the copyright free of the Licensee's later recorded interest.

Under Section 205(d) of the Copyright Act, however, "[a]s between two conflicting transfers, . . . the later transfer prevails if recorded first" in the Copyright Office in the manner necessary to give constructive notice. Under this section, since the Licensee recorded federally and the Lender did not, the Licensee prevails over the Lender.

This is an irreconcilable conflict between the ownership transfer provisions of state and federal law. No amount of drafting can finesse it. Only one system can prevail.

Although not entirely clear, FIPSA apparently does not intend to eliminate federal preemption of the ownership transfer rules for copyrights. Thus, under FIPSA the Licensee would still prevail.

But this means the Lender's security interest has no value against subsequent assignees or exclusive licensees unless the Lender also records in the Copyright Office. Even under FISPA, any prudent lender must still search and record in the Copyright Office to ensure the continuing value of its security.

Thus, FIPSA does not and can not eliminate the "dual filing burden."

2. FISPA Will Significantly Increase the Costs Of Copyright Lending

FISPA provides that the relative priority between secured lenders and lien creditors is determined solely by state law. Copyrighted works often have complex chains of title, with many tiers of derivatives works, licenses, sublicenses and sub-sub-licenses. Under Article 9, foreclosure by a senior secured creditor anywhere higher up in the "chain" wipes out a junior interest. This makes its critical for lender to find any senior interests before it makes a loan.

Under current law, the lender can conduct a single search of the records in the Copyright Office to find all prior copyright liens. Under FISPA, a lender will now need to search the UCC filing systems maintained in the fifty states. This burden will be enormous.

Let me illustrate the magnitude of the problem with a practical example. Assume an independent producer wants to finance a new movie, *Terminator 3*, based on the popular *Terminator* and *Terminator 2* pictures. Since *Terminator 3* will be a derived from several prior works (screenplays and movies), the production lender certainly wants to know all prior security interests against any of these prior works since they would be superior to its loan. Attached is a Copyright Report for the *Terminator* pictures showing the recorded chain of title, but with the copyright mortgages omitted. If FISPA passes, this is what secured lenders will see in the future. Let us try to find all prior copyright mortgages using only this report.

The report shows numerous prior transfers. Any transferor or transferee could have granted a security interest in its rights so we must search each one. Ignoring duplicate entries and transfers that may not affect our new production, it looks like there are still 94 separate entities to search. The Copyright Report does not show where they are located, so we must search under the rules in all fifty states and the District of Columbia.

There are several state variants regarding the place to file a security interest. For a general intangible like a copyright, 26 states only require filing in the Secretary of State, while 14 others can also require an additional filing in the county where the debtor is located. (HAWKLAND, LORD & LEWIS UCC SERIES, §§ 9–401 *et. seq.* (1997 ed.).) According to one major searching service, there are 6,400 potential filing jurisdictions in the United States. How will our production lender find all prior lien filings, and how much will it cost?

Here is an analysis based on the going charges of a well known search company.

- *Locating the Corporations:* It looks like 90 of the entries in the Chain of a Title are corporations. We can conduct a 50 state search to locate their place of incorporation at $365 per debtor, *i.e.* $365 x 90 = $32,850.
- *Searching the Corporations:* Now that we know where they are located, we must search the local UCC filings there. Searching fees vary per state. In California, a search at the Secretary of State costs $34. No county search is required for intangibles. If all of these companies are headquartered in California, then we must conduct 90 UCC searches at a cost of $34 x 90 = $3,060.
- *Copies of Filing:* The UCC searches only disclose the UCC–1s filed against the debtor, not against the copyright in *Terminator*. One transferor alone, Carolco Pictures, had more than 1,000 UCC–1 filed against it. (Each time it produced a picture, the lenders filed a UCC–1 to cover the physical materials). To find out which UCC–1s apply to *Terminator*, we must order a copy of each one. The cost in California is $1.25 per page. If we make the conservative assumptions that each UCC–1 is only 1 page, and that all 90 debtors only have only 2,400 UCC–1s in total filed against them, this means an additional cost of $1.25 x 2,400 = $3,000.
- *Reading The UCC–1s:* Then somebody has to read all 2,400 UCC–1s to determine which ones apply to *Terminator*. If a legal professional could read one UCC–1 a minute, it would still take 40 hours to read them all. If were only charged $100 per hour, that is an additional $4,000.

- *Individuals:* There are four individuals identified in the Copyright Report—the screenplay writers. There is no facility for nationwide searches for individual locations like there is for corporations, so to be sure we have identified all security interests we must search the Secretary of State in all 50 states, plus all the counties in the additional 14 states that require dual filings. Let us assume, conservatively, this means searching 100 jurisdictions, or 4 x 100 = 400 searches. The costs is $34 per state search, and $49 per county search, i.e. ($34 x 200) + ($49 x 200) = $16,600. We will assume no copy or reading problem.
- *Judgment Liens:* We still have the judgment liens. Currently, a lien creditor who does not record in the Copyright Office remains junior to a federally recorded copyright mortgage (*In Re Peregrine, supra* 116 B.R. fn. 16; *LeFlore* v. *Grass Harp Productions, Inc.*, 67 Cal.Rptr. 340, fn. 1 (Cal.App. 1997), although the case law is admittedly sparse. This means that currently a Copyright Report is sufficient to disclose any prior lien creditors. Under Article 9–301(1)(b), however, a party who becomes a lien creditor by levy or attachment before the security interest is perfected has priority. (Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UCC, ¶3.03[2][c] (1994 Rev. Cum. Ed.).) Under FIPSA, our production lender would need to search at the state level to find prior lien creditors. Again, there are many state variations as to when lien creditor status arises (filing, levying) notice rules (some states include judgment liens with UCC filings) and procedures. (*See* Coogan, Hogan, Vagts & McDonnell, SECURED TRANSACTIONS, Chpt. 7E (Matthew Bender, 1998).) Since many copyright owners operate nationally, and copyrights exist everywhere, a judgment lien affecting the copyright might be recorded in any of the 6,400 filing locations nationwide. Searching them all would require examining all 94 parties in all 6,400 locations at $49 per search—for a staggering cost of $29,478,400. Let us assume we only need to search in the counties where the parties are located. Then we still need an additional 94 searches at $49 a search, or $4,606.

The following table compares the admittedly hypothetical costs of finding all liens that might apply to a *Terminator 3* production loan under current law and under FIPSA.

Search Cost Comparison for Terminator 3 (Estimates)

	Current Law		FISPA	
	Documents	Cost	Documents	Cost
Federal Search	1	$250	1	$250
State Searches for Corp. Locations	0	0	100	$32,850
State & County UCC Corp. Searches	0	0	100	$3,060
Copies of State UCC filings	0	0	2,400	$3,000
Review of UCC filings	0	0		$4,000
Individual Searches	0	0	400	$16,600
Judgment Lien Searches	0	0	94	$4,606
Total	1	$250	3,095	$64,366

Of course, we could get lucky. We could find the parties after searching only a few locations. But we cannot guarantee it.

Terminator is not unusual. There are many U.S. motion pictures with chains of title just as elaborate, if not more so. Copyrights have complex chains of title. A remote transferee often has no way of knowing where prior transferors are located other than by searching the public records. Since copyrights are national assets, a remote transferee must be prepared to search public records on a national scale.

The average independent motion picture costs $2 million. They cannot absorb the uncontrollable costs that will be required under FISPA to obtain a production loan. It will mean these pictures cannot be produced at all—or that they must be financed and produced outside the United States. Independent producers are responsible for close to 148,000 American jobs nationwide. FIPSA threatens them all.

A BETTER SOLUTION

As we mentioned, AFMA and AFIs do not believe that the current system is perfect. To the contrary, we have for several years advocated reform. Two problems need attention from the point of view of lenders:

- *Floating liens:* The ability to file a "floating lien" that covers all of the debtor's assets in a single filing.
- *After-Acquired Property:* The ability to have the lien attach to after-acquired property.

Article 9 does have legal rules to accommodate the creation, attachment and foreclosure of floating liens and after-acquired property. The problem is that Article 9 does not have the facilities for filing and perfection with regard to these types of interests where copyrights are concerned. As the previous discussion indicates, it is incapable of doing so.

That does not mean we cannot solve the problem. Copyrights are federal rights; they deserve a federal solution. AFMA has previously proposed a solution that preserves the essential nature of the copyright system and solves these problems. The details are discussed on the attachment. So let must just discuss the concept.

The Copyright Office filings are indexed against works. Article 9 filings are indexed against persons (debtors). To solve the problem, we need to create a facility in the Copyright Office for constructive notice filings against persons as well as works.

The idea is to allow the Copyright Office to establish a "person index." Persons (companies or individuals) with a copyright interest can file a "person registration statement" just like a copyright work registration statement. Recorded transfers can then be indexed against the parties in the "person register" or against the work in the current "work register." These filings will be linked in a computerized, relational database. Either one will have constructive notice and create priority under federal law, and the necessary perfection under state law.

This is essentially the same system the title insurance companies use for land titles. They maintain two indexes: a "lot book" for the properties, and a "general index" describing filings against the persons. They search both to issue a title policy.

This is also the system used in all the major database vendors to create "relational databases." It is a well understood problem with well documented solutions.

In practice, the system could be simple to use. A secured creditor loaning against a copyright need only insure that either the work or the debtor is registered. The lender can then, in principle, file an additional copy of its UCC–1 financing statement with the Copyright Office to perfect against the copyright assets. One extra filing. No multiple searching. No excessive costs.

Again, the exact details are explained in the attachments.

CONCLUSION

The 140 member companies of AFMA, and the 22 banks and financial institutions in the AFI, support needed federal legislation to update the current system for securing copyright mortgages. We endorse the goal of FISPA, but cannot under any circumstances support its "mixed filing" methodology.

Copyrights are national treasures. They deserve a national solution. We look forward to working on a system that will solve current problems while preserving the integrity of the federal copyright system.

LIST OF ATTACHMENTS

Documents Discussed In Statement

- Copy of Copyright Research Report For Terminator 2.

Documents Advocating Positive Solutions

- Letter dated April 6, 1999 from Allen R. "Mike" Frischkorn, President of AFMA, to House Subcommittee on Courts and Intellectual Property enclosing proposed improvement legislation for copyright financing.
- AFMA proposed amendments to Copyright Act to improve copyright financing.

- Memo from Lorin Brennan and Prof. Ronald Mann describing benefits of AFMA proposal, with attached Concept Paper

Documents Regarding "Mixed Filing System

- Memo dated November 30, 1998 to ABA describing objections to "mixed filing" system in FISPA.

T&T

Copyright Research Report

Client Name: Carolco Service, Inc.

Attention: Ms. Darnell Young

Date Received: 12/21/92

Date Mailed: 12/21/92

Property Searched: TERMINATOR 2

For/By: Motion Picture

Analyst: Jerry L. Robb/amr

Scope of Search: Full

Service: _____ Reg. __X__ Expedited

Acceptance and reliance upon this report by the client constitutes an acceptance of its terms, conditions and limitations. Any liability arising out of the preparation of this report is limited to a refund of the search fee paid.

We have taken all reasonable steps to ensure the completeness and accuracy of this report; however, due to the highly subjective nature of copyright and title searching we cannot otherwise guarantee these results. This search is valid only for the property or title noted above. If the property or title which was the subject of this search is changed, even slightly, a new search should be conducted. Please note that this report in no way constitutes a legal opinion.

Thomson & Thomson COPYRIGHT RESEARCH GROUP, 500 E Street, SW, Suite 970, Washington, DC 20024-2710
Telephone: (202) 488-3900 (800) 336-6650 FAX: (800) 523-6623 Telex: 6974942 (CPYRGHT)

Thomson & Thomson

December 21, 1992

VIA OVERNIGHT

Ms. Darnell Young
Carolco Service Inc.
8800 Sunset Blvd.
3rd Floor
Los Angeles, CA 90069

Copyright Report - TERMINATOR 2

Dear Ms. Young:

Boston • Washington, D.C. • Los Angeles • Chicago • Antwerp • London • Montreal • Toronto

A search of the records of the Copyright Office and the records and files of this office reveals that the motion picture entitled TERMINATOR 2: JUDGMENT DAY, starring Arnold Schwarzenegger and Linda Hamilton, a Mario Kassar presentation of a Pacific Western production in association with Lightstorm Entertainment, produced and directed by James Cameron, was released in the United States on July 3, 1991 by Tri-Star Pictures. According to the copyright application, it was created in 1991, published July 3, 1991 and registered for copyright in the name of Carolco Pictures, Inc., July 9, 1991, under entry No. PA: 527-728. The application author is listed as Carolco International, N.V. and Carolco Pictures, Inc., employers for hire. Pre-existing material consists of a screenplay and copyright is claimed on the motion picture version.

"Baseline" reported on October 28, 1992 that the motion picture is being released as follows:

Tri-Star Pictures (North America)
Carolco (International sales)
Guild Film Distribution (Great Britain)
Penta Distribuzione/Cine Italia (Italy)
Unirecord International (Spain)
Columbia Tri-Star Film Distributors (Australia, Norway, Finland, Sweden, Denmark, France, Switzerland, Germany, Latin America, Hong Kong, Philippines, New Zealand, Japan, Taiwan)
SF Norge (Norway)
Concorde Film (Netherlands)
Independent (Belgium)
Twentieth Century Fox (Switzerland)
Nordisk (Denmark)
Guild Entertainment Central Europe (video--Czechoslovakia)
Interama (Czechoslovakia)
VCL/Carolco Communications (video-German speaking territories)
Orbis Communications (tv/syndication--United States)
RTL Plus (television--Germany)
Request TV (pay-per-view--United States)
LIVE Home Video (video--United States)
Record Vision (video--Spain)

500 E Street, SW Suite 970, Washington, D.C. 20024-2710 Telephone: 202-488-2800 Fax: 202-546-8089 Telex: 6974942 (CPYRGHT)

"Baseline" also reports that the motion picture has been widely released abroad.

Underlying Work

The motion picture is based on a screenplay by James Cameron and William Wisher, which was created in 1991 and registered for copyright as an unpublished work in the name of Carolco Pictures, Inc., under the title TERMINATOR 2: JUDGMENT DAY, June 10, 1991, under entry No. PAU: 1-513-625. The application authors are listed as Carolco International, N.V. and Carolco Pictures, Inc., employers for hire.

Reference is made to the following screenplays also entitled TERMINATOR 2, although it is not clear if they relate to the motion picture in question:

TERMINATOR II: Screenplay (third draft--91 pages) by John Wall, created in 1987, and registered for copyright as an unpublished work in the name of John Wall, August 26, 1987, under entry No. PAU: 1-046-524.

TERMINATOR II: Screenplay by John Wall (96 pages) created in 1989, and registered for copyright in the name of John Wall, April 17, 1989, under entry No. TXU: 367-387. The application states that this work was previously registered under entry No. PAU: 1-046-524, and that copyright is claimed on the additional text.

The motion picture TERMINATOR 2: JUDGMENT DAY is a sequel to the motion picture entitled THE TERMINATOR, a work in approximately 107 minutes running time, starring Arnold Schwarzenegger, a Pacific Western production, directed by James Cameron, produced by Gale Anne Hurd and released by Orion Pictures. According to the copyright application, it was created in 1984, published October 26, 1984 and registered for copyright in the name of Cinema '84, February 22, 1985, under entry No. PA: 241-495. Copyright is claimed on the entire work except for some previously published music.

Variety, issue of October 21, 1984, described THE TERMINATOR as a Hemdale production of a Pacific Western picture.

THE TERMINATOR was telecast over the HBO cable television network on September 15, 1985 and over the Cinemax network on the same date. It was telecast over the NBC television network on September 27, 1987.

It is currently listed as available for television distribution through Carolco Television International and for export through Orion Entertainment. It is also currently listed as available in video format through HBO Video, Image Entertainment, Inc., Hemdale Home Video, Inc. and Nova Home Video.

The motion picture is based on a screenplay entitled TERMINATOR by James Cameron and Gale Anne Hurd, which was created in 1983, and registered for copyright as an unpublished work in the name of Hemdale Film Corporation, February 3, 1984, under entry No. PAU: 584-564.

Recorded Instruments

The following documents have been recorded in connection with TERMINATOR 2:

By Short Form Assignment dated January 3, 1990, recorded January 16, 1990 in Vol. 2514, pages 41-42, Hemdale Film Corporation, Hemdale Holdings, Ltd., Hemdale Film Sales Corporation and Hemdale Communications, Inc. granted all of its rights, titles and interests in and to the motion picture TERMINATOR, including all literary material written in connection with all sequels, remakes, prequels, spin-offs, film/television/video programs and/or series relating to the published motion picture, and with a proposed motion picture tentatively entitled TERMINATOR 2, in perpetuity and without limitation, to Carolco International, N.V., subject to the terms and conditions of the Assignment Agreement between the parties dated as of January 3, 1990.

By instrument dated February 7, 1990, recorded November 20, 1990, in Vol. 2595, page 290, American Gothic Productions, Inc. assigned and quitclaimed to Carolco International, N.V., in perpetuity all right, title and interest in and to all literary material written by William Wisher, pursuant to the Employment Agreement between William Wisher and American Gothic Productions, Inc. dated as of February 6, 1990, with respect to the proposed theatrical motion picture entitled TERMINATOR 2, subject to all of the terms, conditions and provisions contained in the agreement between American Gothic Productions, Inc. and Carolco International, N.V., dated as of October 27, 1989.

By Assignment dated February 7, 1990, recorded November 20, 1990, in Vol. 2595, page 290, American Gothic Productions Inc. assigned and quitclaimed to Carolco International N.V., in perpetuity, all its right, title and interest in the literary material by William Wisher pursuant to the Employment Agreement dated as of February 6, 1990 between Wisher and AGP with respect to the proposed motion picture entitled TERMINATOR 2. This Assignment is subject to the terms of a deal memo between the parties dated as of October 27, 1989.

By instrument dated May 22, 1990, recorded June 13, 1990, in Vol. 2550, page 211, Carolco International, N.V. granted to Tri-Star Pictures, Inc. a license to exercise exclusive theatrical, non-theatrical, video and airline distribution rights relating to the feature length motion picture photoplay entitled TERMINATOR 2, throughout France and the French Ex-Colonies, East Germany (except video), West Germany (except video), Austria (except video), Denmark, Finland, Iceland, Norway, Sweden, Australia, New Zealand, South America, Central America, Dominican Republic, Mexico, Puerto Rico (except video), East, West and South Africa, Switzerland and Liechtenstein, Hong Kong, Macao, the Philippines and Belgium (video only), for the term set forth in the Distribution Agreement between the parties, dated as of May 23, 1990. The entire recorded document is executed in accordance with and is subject to the terms, provisions and restrictions of the Security Agreement between the parties dated as of April 25, 1990 and the Distribution Agreement between the two parties dated as of May 23, 1990.

By Assignment and Mortgage of Copyright dated September 20, 1990, recorded October 11, 1990, in Vol. 2584, page 340, Carolco Pictures Inc., pursuant to the Distribution Agreement dated as of November 15, 1988 between it and Tri-Star Pictures Inc., granted to Tri-Star a license to exercise exclusive theatrical, non-theatrical and airline distribution rights in the motion picture entitled TERMINATOR II throughout the United States and its territories and possessions (excluding Puerto Rico and the U.S. Virgin Islands) and Canada and its territories and possessions (as specifically set forth in the Distribution Agreement) for the term defined in that Agreement. Solely to the extent necessary for the assignee to exercise the rights granted, assignor hereby mortgaged and assigned to assignee all its right, title and interest in the copyright in the underlying property and the picture and all renewals and extensions thereof and has also granted a security interest with respect to the picture in the "collateral" as defined in the Security Agreement dated as of April 25, 1990.

By instrument dated September 20, 1990, recorded October 11, 1990, in Vol. 2584, page 340, Carolco Pictures, Inc. granted to Tri-Star Pictures, Inc. a license to exercise exclusive theatrical, non-theatrical and airline distribution rights relating to the feature length motion picture entitled TERMINATOR 2, throughout the United States and its territories and possessions (excluding Puerto Rico and the U.S. Virgin Islands) and Canada and its territories and possessions for the term defined in the Distribution Agreement between the parties dated as of November 15, 1988. The entire document is executed in accordance with and is subject to the terms, provisions and restrictions of the Security Agreement dated as of April 25, 1990 and the Distribution Agreement dated as of November 15, 1988, between the parties.

By a Merchandising License Agreement dated as of January 16, 1991, recorded October 21, 1991, in Vol. 2701, pages 60-86, Carolco Pictures, Inc. and Carolco International, N.V. granted to Kenner Products the sole and exclusive license to any and all uses of the storylines, scripts, designs, art work, props, characters, physical properties, trademarks, logos and copyrights associated with the motion picture entitled **TERMINATOR 2: JUDGMENT DAY** and any sequel, prequel, spin-off, live or animated television or other video program or series based on any of the same throughout the world for the term commencing on January 31, 1991 and expiring June 30, 1994 including the right to manufacture, sell and distribute various licensed articles including action figures, arts and crafts, board games, electronic toys, toy weapons and others, as more fully described in Attachment A. Also granted was the right to use the name and likeness of the principal performers Arnold Schwarzennegger and Linda Hamilton.

By instrument dated as of January 31, 1991, recorded February 11, 1991, in Vol. 2619, pages 412-414, Carolco Pictures, Inc. exclusively granted, assigned and transferred to Live Home Video, Inc. all rights of every kind and nature under copyright to exploit the motion picture entitled **TERMINATOR 2** by any and all means and in all languages in the home video media, throughout the United States and its territories and possessions, including Puerto Rico and the United States Virgin Islands and Canada, for a term of 15 years following the first home video release. Following the expiration of the said term, the document stated there will be a six month non-exclusive sell-off period. The entire document is executed in accordance with the terms and conditions of the agreement between the parties dated July 27, 1987, restated as of October 15, 1987 and further amended on April 12, 1990.

By Instrument of Transfer dated March 23, 1992, recorded April 2, 1992, in Vol. 2752, pages 191-194, Carolco International N.V. assigned to RCS Video Services Antilles, N.V. all its right, title and interest in the free television rights in this motion picture in the U.K. for 15 years from the availability date (not given) for the motion picture, provided that the terms shall not commence prior to the exercise of the offer granted to RCS under the Offer Agreement by and between RCS and CINV dated as of March 20, 1992, subject to the terms of the Agreement as well as the Option Security Agreement dated as of March 20, 1992 between the parties.

On April 1, 1992, recorded April 2, 1992, in Vol. 2752, pages 195-199, Carolco International N.V. executed an Option Copyright Mortgage and Assignment to RCS Video Services Antilles, N.V. in connection with this motion picture and 16 others.

By Copyright Assignment dated May 1, 1987, recorded May 6, 1987 in Vol. 2273, pages 309-334, Cannon Film Distribution, V.O.F., Cannon Releasing Corporation, Cannon Screen Entertainment (Holdings) Ltd., Cannon Tuschainski Film Distribution, B.V., Cannon City Film Distribution, Cannon Distributors, Inc., Bearsphere, Ltd., Cannon Argonaut Films, Ltd., Cannon Badger Films, Ltd., Cannon Berwick Films, Ltd., Cannon Broadwick Street Films, Ltd., Cannon Dreamaxe, Ltd., Cannon Elstree Distributors, Ltd., Cannon Elstree Studios, Ltd., Cannon Films, Ltd., Cannon Film Productions, Ltd., Cannon Film Sales, Ltd. Cannon Individual Pictures, Ltd., Cannon Lion International Films, Ltd., Cannon Nextlow, Ltd., Cannon Pathe Equipment Ltd., Cannon Penits Consultants, Ltd., Cannon Tudor Productions, Ltd. Cannon Vale Film Productions, Ltd. Cannon Video, Ltd., Cannon Wardour Street Films, Cannon Cinema Elilia, S.R.L., Cannon Cinema, G.m.b.H., Cannon Cinemas, Ltd., Cannon City, B.V., Cannon City Produktie Maatschappij, B.V., Cannon Irisbook, Ltd., Cannon Music, Ltd. Cannon Productions, Inc., Cannon Productions, S.R.L., Cannon Properties, Inc., Cannon Screen Entertainment, Inc., et al assigned to Loopservice Ltd., Cannon Australia, B.V. & Winter Screen Entertainment Inc. all respective rights, titles and interests in all copyrights now owned or hereafter acquired by any of them including this motion picture, and including without limitation original, renewal, extended and reversionary terms of copyright, in perpetuity throughout the universe, subject to the terms of the Library Agreement (date not given).

By Copyright Assignment dated May 1, 1987, recorded July 7, 1987 in Vol. 2273, pages 355-404 Cannon International, V.O.F. by Cannon International, B.V., general partner, Cannon Films, Inc., Cannon Screen Entertainment, Ltd., Cannon S B Films, Inc. and Cannon Film Sales, Ltd. granted to Weintraub Entertainment (Rights), Ltd., Diepvriescentrale Hengelo Beleggingen, B.V., which name will be changed to Weintraub Entertainment Group, B.V., and Weintraub Entertainment Group, Inc. all rights, titles and interests in all copyrights in perpetuity throughout the universe in numerous properties including the above motion picture, pursuant to a motion picture library purchase agreement dated May 1, 1987.

By Exclusive License Agreement dated May 21, 1985, recorded December 23, 1985, in Vol. 2152, pages 520-542, Trudeau Cummings Productions assigned to Karl-Lorimar Home Video Inc. the exclusive license to distribute and otherwise exploit this motion picture and eleven others in all forms of audiovisual devices, including videocassettes, videodiscs and such video devices now or hereafter known for a term of seven years from the date the picture is first released on video cassette, worldwide. The grant includes the right to distribute the videocassettes in the institutional market, including medical, educational and religious institutions, retirement homes, libraries, civic groups, clubs, summer camps and institutions with shut-ins for their non-commercial, non-theatrical exhibition. The licensor did not authorize the exhibition in any and all other media including but not limited to theatrical, pay television, free television and/or public television until at least one year after the picture is first released on videocassette.

By Copyright Assignment dated May 1, 1987, recorded July 7, 1987 in Vol. 2273, page 464-519, Cannon Film Distribution, V.O.F., Cannon Releasing Corporation, Cannon Screen Entertainment (Holdings), Ltd., Cannon Tuschainski Film Distributors, Inc., Bearsphere, Ltd., Cannon Argonaut Films, Ltd., Cannon Badger Films, Ltd., Cannon Berwick Films, Ltd., Cannon Broadwick Street Films, Ltd., Cannon Dreamaxe, Ltd., Cannon Elstree Distributors, Ltd., Cannon Elstree Studios, Ltd., Cannon Films, Ltd., Cannon Film Productions, Ltd., Cannon Film Sales, Ltd., Cannon Individual Pictures, Ltd., Cannon Lion International Films, Ltd., Cannon Nextlow, Ltd., Cannon Pathe Equipment, Ltd., Cannon Penits Consultants, Ltd., Cannon Tudor Productions, Ltd., Cannon Vale Film Productions, Ltd., Cannon Video, Ltd., Cannon Wardour Street Films, Cannon Cinema Elilia, S.R.L., Cannon Cinema, G.m.b.H., Cannon Cinemas, Ltd., Cannon City, B.V., Cannon City Produktie Maatschappij, B.V., Cannon Irisbook, Ltd., Cannon Music, Ltd., Cannon Productions, Inc., Cannon Productions, S.R.L., Cannon Properties, Inc., Cannon Screen Entertainment, Inc., et al. granted to Weintraub Entertainment (Rights), Ltd., Diepvriescentrale Hengelo Beleggingen, B.V., which name will be changed to Weintraub Entertainment Group, B.V. and Weintraub Entertainment Group, Inc. all rights, titles and interests in all copyrights in perpetuity throughout the universe in numerous properties including the above motion picture, pursuant to a bill of sale dated May 1, 1987.

By Assignment dated May 1, 1987, recorded July 8, 1987 in Vol. 2274, pages 171-223 Cannon Productions, N.V., Cannon Film Distributors, V.O.F., Cannon Tuschinski Beheer, B.V., Cannon France, S.A., Cannon Cinema Italia, S.R.L., Cannon Releasing Corporation, Cannon Screen Entertainment (Holdings), Ltd., Cannon Tuschainski Film Distribution, B.V., Cannon City Film Distribution, Cannon Distributors, Inc., Bearsphere, Ltd., Cannon Argonaut Films, Ltd., Cannon Badger Films, Ltd., Cannon Berwick Films, Ltd., Cannon Broadwick Street Films, Ltd., Cannon Dreamaxe, Ltd., Cannon Elstree Distributors, Ltd., Cannon Elstree Studios, Ltd., Cannon Films, Ltd., Cannon Film Productions, Ltd., Cannon Film Sales, Ltd., Cannon Individual Pictures, Ltd., Cannon Lion International Films, Ltd., Cannon Nextlow, Ltd., Cannon Pathe Equipment, Ltd., Cannon Penits Consultants, Ltd., et al. granted to Weintraub Entertainment (Rights), Ltd., Diepvriescentrale Hengelo Beleggingen, B.V., which name will be changed to Weintraub Entertainment Group, B.V., and Weintraub Entertainment Group, Inc. all rights, titles and interests in all copyrights in perpetuity throughout the universe in numerous properties including the above motion picture, pursuant to a bill of sale dated May 1, 1987.

By Copyright Assignment dated May 1, 1987, recorded July 8, 1987 in Vol. 2274, pages 224-275, Cannon Productions, N.V., Cannon Film Distribution, V.O.F., Cannon Tuschinski Beheer, B.V., Cannon France, S.A., Cannon Cinema Italia, S.R.L., Cannon Releasing Corporation, Cannon Screen Entertainment (Holdings) Ltd., Canhon Tuschainski Film Distribution, B.V., Cannon City Film Distribution, Cannon Distributors, Inc., Bearshpere, Ltd., Cannon Argonaut Films, Ltd., Cannon Badger Films, Ltd., Cannon Barwick Films, Ltd., Cannon Broadwick Street Films, Ltd., Cannon Dreamake, Ltd., Cannon Elstree Distributors, Ltd., Cannon Elstree Studios, Ltd., Cannon Films, Ltd., Cannon Film Productions, Ltd., Cannon Film Sales, Ltd., Cannon Individual Pictures, Ltd., Cannon Lion International Films, Ltd., Cannon Nextlow, Ltd., Cannon Pathe Equipment, Ltd., Cannon Penits Consultants, Ltd., et al assigned to Loop Service Ltd., Cannon Australia, B.V. and Winter Screen Entertainment, Inc. all respective rights, titles and interest in all copyrights now owned or acquired by any of them, including this motion picture, for the original and renewal terms of copyright, throughout the universe, as more particularly set forth and subject to the terms of a Library Agreement of even date between the parties.

By Memorandum of Exclusive License dated April 8, 1988, recorded August 7, 1989 in Vol. 2481, pages 396-404, Weintraub Entertainment Group Inc. and Winterscreen Entertainment Inc. licensed to HBO Video Inc. the exclusive rights to manufacture and to distribute for sale and/or rental the English, French and Spanish language versions of numerous motion pictures including this one by all means of consumer video devices throughout the United States and Canada and their respective territories, possessions, commonwealths and trusteeships as well as their military and civilian installations for a term commencing on April 1, 1988 and ending on the earlier of the date of a) four years thereafter or b) the expiration of the distribution period specified in schedule A of the license agreement with respect to specific motion pictures, in this case March 31, 1990, subject to the terms and conditions of the license agreement dated as of March 31, 1988 between the parties. By instrument dated April 8, 1988, recorded August 7, 1989 in Vol. 2481, pages 396-404, Weintraub Entertainment Group, Inc. and Winter Screen Entertainment Inc. assigned to HBO Video Inc. the exclusive right to distribute for sale or rental the English, French and Spanish-language versions of this motion picture and 227 others by all means of consumer video devices for a term commencing April 1, 1988 and ending on the earlier of the date (a) four years thereafter or (b) expiration of the distribution rights (described as full term--not further identified) in the United States and Canada and their respective possessions and territories, subject to the terms of a license agreement between the parties dated April 31, 1988.

By instrument dated as of October 19, 1988, recorded December 30, 1988, in Vol. 2393, pages 306-316, it was agreed between Orbis Communications, Inc. and Credit Lyonnais Bank Nederland, N.V. that if the bank forecloses on its bank security interest in connection with this motion picture, then Orbis will attorn to the bank in the place of Hemdale, and the bank will not disturb the exercise of Orbis' distribution rights under the distribution agreements.

By Short Form Assignment dated January 3, 1990, recorded January 16, 1990 in Vol. 2514, pages 41-42, Hemdale Film Corporation, Hemdale Holdings, Ltd., Hemdale Film Sales Corporation and Hemdale Communications, Inc. granted all of its right, title and interest in and to the motion picture TERMINATOR, including all literary material written in connection with all sequels, remakes, prequels, spin-offs, film/television/video programs and/or series relating to the published motion picture, and with a proposed motion picture tentatively entitled TERMINATOR 2, in perpetuity and without limitation, to Carolco International, N.V., subject to the terms and conditions of the Assignment Agreement between the parties dated as of January 3, 1990.

By Copyright Assignment dated July 16, 1991, recorded October 1, 1991, in Vol. 2695, pages 49-107, Vestron, Inc., Bulls' Head Music, Inc., Children's Video Library, Inc., Film Sales International, Inc., High Ridge Productions, Inc., Interaccess Film Distribution, Inc., Lightning Music, Inc., Lightning Pictures, Inc., Long Ridge Development Corporation, P.V.S.I. Holdings, Inc., Video Store, Inc., VCD, Inc., Vestron Distribution, Inc., Vestron Entertainment, Inc., Vestron Music, Inc., Vestron Music Video, Inc., Vestron Pictures, Inc., Vestron Promotions, Inc., Vestron Records, Inc., Vestron Television, Inc., Vestron Video, Inc., VMP, Inc., VPI, Inc. and V.R. Management, Inc., pursuant to an Asset Purchase Agreement dated as of October 30, 1990, as amended, between Vestron Inc., on the one hand, and Vestron Acquisition Corporation, a third tier wholly-owned subsidiary of LIVE Entertainment Inc., on the other hand, sold, grated, conveyed and assigned to Vestron Acquisition Corporation, for the United States and Canada and their territories and possessions, and to LIVE-IVE Entertainment N.V., d/b/a LIVE Entertainment International, for all countries and territories outside the U.S. and Canada and their territories and possessions, all of their right, title and interest in and to all copyrights, including, without limitation, original, renewal, extended and reversionary terms of copyrights, in perpetuity and throughout the universe in and to the Film Rights and Film Assets (as defined in the above referenced Agreement), including, but not limited to, the Film Rights and Film Assets in all properties listed in an attached Schedule A, which included this work and numerous others, subject to the terms and conditions of the above referenced Agreement.

The in-process records of the Copyright Office disclose that the following documents have been received, but are not as yet available in the public records:

Document received from Rosenfeld, Meyer & Susman on August 6, 1992 in connection with **TERMINATOR 2: JUDGMENT DAY;**

Document received from Pennie & Edmonds on October 28, 1992 in connection with **TERMINATOR II.**

No further document affecting any right, title or interest in the motion picture entitled **TERMINATOR 2** is found of record in the Copyright Office.

The records disclose the following documents recorded in connection with the motion picture entitled **THE TERMINATOR:**

By instrument dated January 26, 1983, recorded May 1, 1984 in Vol. 1983, pages 389-391, Hemdale Leisure Corporation assigned to Home Box Office Inc. the exclusive right to exhibit and distribute the motion picture entitled **THE TERMINATOR** by all means of television other than standard broadcast television, throughout Canada and the United States, including its territories, commonwealths and possessions, for two separate periods, the first for a term of at least 18 months commencing on the first anniversary of the theatrical release of the film in the United States, and ending either five years after such commencement or ninety days prior to the commencement of either ABC, CBS or NBC exhibiting the film; and for a second period of twelve months commencing either 90 days after the end of the network license period or 120 days after HBO's receipt of notice of the last permitted exhibition during the network license period. Also granted was the exclusive right to distribute the film by pay-TV throughout the English-speaking world, other than Canada and the United States, on a country-by-country basis, for approximately the same period of time, subject to the terms of a License Agreement between the parties dated as of December 10, [illegible]

By Videogram Agreement dated April 16, 1985, recorded November 22, 1985, in Vol. 2110, pages 388-408, Trudeau Cummings Productions assigned to WidMark the exclusive right to manufacture and distribute video devices (tapes, cassette, disc, card and other devices whether now known or hereinafter invented, including videotapes, videocassettes and videodiscs) for a period of five years throughout the United States, its territories and possessions, and the Dominion of Canada, subject to the terms of an Agreement between the parties dated as of April 16, 1985.

There is of record an Assignment of Copyrights dated as of October 1, 1991 and December 23, 1992, recorded February 16, 1993 in Vol. 2788, pages 27-28, between Carolco Pictures, Inc. and Showtime Networks. This document has not yet been filmed and is therefore not as yet available in the public records.

The following documents are still in-process and are not yet available in the public records in connection with the motion picture entitled **TERMINATOR 2**:

Document received from Rosenfeld, Meyer & Susman on August 6, 1992.

Document received from Pennie & Edmonds on October 28, 1992.

No further document affecting any right, title or interest in the motion picture entitled **TERMINATOR 2** or its underlying work is found of record in the Copyright Office.

The following additional documents are of record in the Copyright Office in connection with the motion picture entitled **TERMINATOR**:

By Short Form Purchase Agreement dated as of December 31, 1989 and February 20, 1992, recorded March 4, 1992 in Vol. 2746, pages 456-460, Hemdale Holdings, Ltd., Hemdale Film Corporation, Hemdale Film Sales Corporation and Hemdale Communications, Inc. jointly and severally sold to Credit Lyonnais Bank Nederland, N.V. absolutely and without limitation under copyright and otherwise (1) all advances and amounts payable to the Seller after January 1, 1990 in connection with several motion pictures, including this one, and (2) all of their rights under that certain Agreement dated as of October 19, 1988 between the Sellers and Orbis Communications, Inc. to proceed against Orbis Communications, Inc. in respect of any non-payment of any such advance or amount due thereunder. This Purchase Agreement is executed in accordance with and is subject to the terms and conditions of that certain Factoring Agreement, dated as of

December 31, 1989 among Credit Lyonnais Bank Nederland and the Seller.

On December 18, 1992, this office submitted the following document for recordation, which has not as yet been assigned a volume and page number:

By Mortgagors' Declaration of Name Change dated as of December 4, 1992, Hemdale Communications, Inc., Hemdale Releasing Corp., Hemdale Film Productions Corp., Hemdale Motion Pictures, Inc., Hemdale Media, Inc., Hemdale Productions Company Corp, Hemdale Enterprises, Inc., Hemdale Video, Inc., Hemdale Film Sales Corporation, Hemdale (UK) Ltd. and Hemdale Film Distribution PLC declared that it is the intention of each Hemdale Company that the security interests of Credit Lyonnais Bank Nederland, N.V. in several motion pictures, including this one, shall remain in full force and effect notwithstanding the fact that each Hemdale Company has changed its name, and each Hemdale Company thereby ratifies and reaffirms each existing mortgage to which it is a party. The Declaration includes a schedule of the existing mortgages and the motion pictures affected by this declaration and a list of the following name changes:

<u>Former Name</u>	<u>Current Name</u>
Hemdale Communications, Inc.	NSB Communications, Inc.
Hemdale Releasing Corporation	NSB Releasing Corporation
Hemdale Film Productions Corp.	NSB Film Productions Corp.
Hemdale Motion Pictures, Inc.	NSB Motion Pictures, Inc.
Hemdale Media, Inc.	NSB Media, Inc.
Hemdale Production Co. Corp.	NSB Production Co. Corp.
Hemdale Enterprises, Inc.	NSB Enterprises, Inc.
Hemdale Video, Inc.	NSB Video, Inc.
Hemdale Film Sales Corp.	NSB Film Sales Corp.
Hemdale (UK) Limited	Fortal (UK) Limited

The following documents are still in-process and are not yet available in the public records in connection with the motion picture entitled TERMINATOR:

Document received from LIVE Home Video, Inc. on August 14, 1992

Document received from LIVE Home Video, Inc. on August 28, 1992

Document received from Carolco Pictures, Inc. on October 6, 1992.

AFMA,
Los Angeles, CA, April 20, 1999.

Ms. DEBBIE LAMAN,
Subcommittee on Courts and Intellectual Property,
Committee on the Judiciary,
House of Representatives, Washington, DC.

RE: SECURITY INTEREST IN COPYRIGHTS FINANCING PRESERVATION ACT

DEAR DEBBIE: Thank you for contacting AFMA concerning our views on the Security Interest in Copyrights Financing Preservation Act (SICFPA). As Lorin Brennan and I noted in our telephone conversation, the SICFPA approach will create more problems than it will resolve.

I am enclosing for your information a memorandum, concept paper and draft legislation prepared by Lorin Brennan and Ronald Mann, a law professor at the University of Michigan. This material sets forth a different approach, which we believe will address many concerns which gave rise to the SICFPA, but will do so in a manner that does not cause problems for copyright holders.

After you have reviewed this material, you may wish to contact Lorin, who is a consultant with AFMA, directly with any questions.

Thanks again for contacting us concerning this important issue.

Sincerely,

ALLEN R. FRISCHKORN, JR., *President.*

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PROPOSED COPYRIGHT FILING MODERNIZATION ACT

AMENDMENTS ARE TO TITLE 17, SECTIONS 101 ET. SEQ.

§ 101. Definitions

. . .

A "transfer of copyright ownership" is an assignment, mortgage, exclusive license, *grant of a security interest*, or other conveyance, alienation or hypothecation of a copyright or any of the exclusive rights comprised in a copyright, *currently existing or to be created*, whether or not it is limited in time or place of effect, but not including a nonexclusive license.

§ 205. **Recordation of Transfers and Other Documents**

(a) **Conditions for Recordation.**—Any transfer of copyright ownership or other document pertaining to a copyright *or the interest of a person in 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.

(b) **Certificate of Recordation.**—The Register of Copyrights shall, upon receipt of a document as provided in subsection (a) and of the fee provided by section 708, record the document and return it with a certificate of recordation.

(c) **Recordation as Constructive Notice:** Recordation of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document, but only if *either*—

(1) ***Work Identification:***

(A) 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, and

(B) The work has been registered on or before the date when the document is recorded;

or

(2) ***Person Identification:***

(A) The document, or material attached to it, specifically identifies the person 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 name or identifying information of the person; and

(B) A person identification has been filed on or before the date when the document is recorded with respect to the person; and

(C) Any work to which such document relates is registered no later than five years after the date when the document is recorded.

(d) **Priority Between Conflicting Transfers.**—As between two conflicting transfers, the one executed first prevails if it is recorded, in ~~the~~ *either* manner required to give constructive notice under subsection (c), ~~within one month after its~~

~~execution in the United States or within two months after its execution outside the United States, or~~ at any time before recordation in such manner of the later transfer. Otherwise, the later transfer prevails if recorded first in such manner, and if taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.

(e) **Priority between Conflicting Transfer of Ownership and Nonexclusive License.**—A nonexclusive license, whether recorded or not, *is effective against and* prevails over a conflicting transfer of copyright ownership if the license is evidenced by a written instrument signed by the owner of the rights licensed or such owner's duly authorized agent, and if

(1) the license was taken before execution of the transfer; or

(2) the license was taken in good faith before recordation of the transfer and without notice of it.

(f) ***Transfer of Royalties Only.****—As between two conflicting transfers of a right to receive royalties (or other purely monetary interests including license fees) only with respect to a copyrighted work without any right or privilege to exercise any of the rights in such work granted under this title, priority of the transfers is determined by applicable law other than this title.*

§ 301. **Preemption With Respect to Other Laws.**

[Add new (g)]

(g) The determination and effect of constructive notice and of the priority of transfers and licenses with respect to copyrighted works are governed exclusively by this title.

§ 409A. ***Application for Person Identification***

(a) ***Enabling.****—Any person who has or expects to have an interest in a copyrightable work may file an original or amended application for person identification with the Copyright Office in accordance with this section.*

(b) ***Application:*** *The application for person identification shall be made on a form prescribed by the Register of Copyrights and shall include—*

(1) The current name of the person, and such other information as the Register of Copyrights may prescribe to identify the person;

(2) The current address of the person, and such other information as the Register of Copyrights may prescribe to locate the person;

(3) If the person has previously filed a person identification, the name or filing number for a prior registration, and such other information as the Register of Copyrights may prescribe to locate the prior filing by a reasonable search; and

(4) Any other information regarded by the Register of Copyrights as bearing on the identification of the person.

(c) ***Filing.****—Upon receipt of an application for a person identification that meets the requirements of section (b), and upon payment of the fee specified in section 708, the Copyright Office shall file such application in the public records maintained for such purpose in the Copyright Office, and, if requested, issue a certificate of such filing.*

(d) ***Index.****—The Register of Copyrights shall maintain an index of the registrations, filings and recordings duly made under this title so that a reasonable search of the records of the Copyright Office would disclose:*

(1) For a registered work, all registrations for the work, all documents recorded which reference such work and each person identified as a transferor or transferee in such a document; and

(2) For a person identified in a filed person identification, all registered works in which such person is identified as an author or copyright owner, and all recorded documents in which such person is identified as a transferor, transferee or other similar capacity maintained in the records of the Copyright Office.

(e) ***Reports.****—The Copyright Office upon request made in conformity with the procedures established by the Register of Copyrights and payment of the fee specified in section 708 shall issue a report for a work or a person showing the results of a reasonable search of the records of the Copyright Office as indexed in conformity with section 409A(d). A report issued under this section shall be prima facie evidence of the accuracy of its contents.*

§ 708. **Copyright Office Fees.**

(a) The following fees shall be paid to the Register of Copyrights:

[(1)—(10) Same. Add the following:]

(11) on filing each application under Section 409A for person identification, including the issuance of certificate of filing if filing is made, $20 [or the same as prescribed under section 708(a)(1)];

(12) on the filing of any amendment of a person identification, including the issuance of certificate of filing if filing is made, $20;

(13) on issuance of a report under Section 409A(e), $20 for the first name or title, and for additional names or titles, $10 for each group of not more than 10 names or titles [but not more than $500 in total].

*§711. **Copyright Office Authority.***

*(a) **Sample Forms:** The Register of Copyright may establish procedures for using and filing sample forms for recording documents regarding transfers of copyright, security interests in copyrights, changes in a person's name or location, and other matters consistent this title. The Register of Copyright may allow reduced fees or expedited procedures for use of such forms.*

*(b) **Electronic Authentication:** The Register of Copyright may establish procedures for using and filing any document required or allowed under this title in electronic form with appropriate means to authenticate the genuineness of any such electronic document including by a digital signature. Any document filed in accordance with such procedures will have the same effect under this title as if filed in non-electronic form. The Register of Copyright may allow reduced fees or expedited procedures for use of electronic documents.*

MEMORANDUM—JUNE 22, 1999

To: *Interested Parties*
Fr: Lorin Brennan, Gray Matter LLC
Ronald Mann, Prof. of Law, Michigan Univ. School of Law
Re: *Copyright Office Filing System*

Enclosed are two papers describing our proposed changes to the Copyright Office filing system to facilitate modern development and financing transactions. The first is a Concept Paper describing in principle the changes we believe are needed. The second is draft legislation to implement the proposed changes.

We are sympathetic to the concerns motivating the proposed Security Interests in Copyrights Financing Preservation Act (SICFPA) by its ABA sponsors. However, we believe the approach is simply unworkable. Crucially, the SICFPA fails to adopt to the relational database approach to information management that is the mainstay of all modern data management systems. As such, it can *not* take advantage of the efficiency gains available from an electronic, online environment. Also, by institutionalizing a two-filing system—at both the state and federal levels—it introduces needless complexity and doubt into the simplest transactions.

Our proposal instead authorizes the Copyright Office to create a relational database at the federal level for copyrighted works. It would require the Copyright Office to maintain two filing indexes: one for copyrighted works (the current system); and a new system for interested parties (a "person index"). These indexes will be linked by computer in a relational database. Think of this as an "electronic Rolodex" that can be searched either by work or by person. The current state law system for tracking security interests in personal property is indexed by the debtor ("person"), so our proposed system actually combines both methods in one , unified federal system.

We suggest that a relational system—and only a relational system—can resolve the concerns motivating the SICFPA. Indeed, our proposal solves problems the SICFPA can not even address:

Floating Liens: Lenders want to file "floating liens" that attach to all the copyrighted works of a debtor without the necessity of filing for each work. Under our proposal, a lender could file a financing document with regard to a "person," *e.g.* "all works now owned or acquired by Debtor Co." If Debtor Co. has duly filed a Person Identification Statement in the Copyright Office, this financing document would be recorded in the "person index" against Debtor Co. As Debtor Co. becomes the registered author/copyright owner or transferee of interests in a copyrighted work, these interests would be related to Debtor Co.'s person index filing by the computer's relational database, and in turn related to the financing document. The SICFPA proposes that all the security interest filings be maintained in 50 separate state indexes, so there could never be a relational link, and no way to insure consistency of the filings between the states and the Copyright Office (*i.e.* no "data integrity").

Identity Changes: In addition to lenders, many copyright owners would also like a single filing to relate to all their works. Typical examples are corporate acquisitions or name changes. The SICFPA does nothing for this situation, but our proposal does.

After-Acquired Property: Lenders also want their liens to attach to after-acquired property. Under our proposal, a person identification statement can be filed for interests in copyrighted works that a person has *or* expects to have. As in the previous example, new works would be related to a filing as they are registered. We have proposed a five year period in which registration should occur for such attachment, similar to the renewal period for liens under state law.

Output Deals: Transferees other than lenders would also like to file for works to be created in the future, *e.g.* "the next three productions of Producer Co." A particular example is filing by a distributor against a motion picture or software program while still in production. Note that the SICFPA also does not address this situation for anyone but lenders, but our proposal solves the problem for transferees and lenders alike.

Simplified Searching: Under the SICFPA proposal, a person desiring to loan against a copyright must conduct two searches: one for prior transfers of the work, and another for persons who may have prior security interests. Since many copyright transfers do not identify the location of prior parties in the chain of title, relating transferees with the secured parties can require searching dozens of entities in all fifty states—an extraordinary burden. The UCC–1 financing statements often do not identify what copyrights are encumbered, so a search may not even disclose all creditors. Our proposal allows a single, unified, effective search in the Copyright Office.

Simplified Filing: Even the proponents of the SICFPA admit that it will still require a lender to file in two places—the Copyright Office and the state. Our proposal requires only one filing for copyright interests—the Copyright Office. Where the loan secures collateral other than copyrights, of course two filings will be required, but in that case our proposal is no more burdensome than the SICFPA and far more beneficial.

No Circular Liens: The SICFPA has a serious problem: what happens if the secured creditor forecloses? Which law determines the priority of the purchaser at a foreclosure sale as against a prior transferee who recorded in the Copyright Office? The SICFPA does not—and cannot—reconcile this conflict. Our proposal does.

Consistency With Current Law & Practice: The SICFPA requires a radical change in current law and practice. It would impose serious adverse consequences on "upstream" lenders who finance the creation of copyrighted works in preference to the interests of "down-stream" lenders who loan against the assets of remote licensees. We believe this policy choice is both unwarranted and unnecessary. Our proposal enables new filing methods while still continuing current ones. Since, like current copyright law, it only deals with filing and priority, existing state law rules for creating, attaching and foreclosing floating liens and after-acquired property will remain in place. We merely enable the federal system to accommodate them in parallel with the state system. We do not tear down and start over; we add on and enhance.

Further questions on this proposal can be addressed to: Lorin Brennan or Prof. Ronald Mann.

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CONCEPT PAPER—REFORMING THE COPYRIGHT FILING SYSTEM

- Technological Upgrading—The system should be upgraded to use a relational database of the kind that commercial enterprises routinely use for their data.
  - The existing system, while appropriate for an earlier age, has now become cumbersome, slow, and expensive, hindering financing and development.
  - A relational database will save money by (a) lowering the costs of filing and searching; (b) eliminating the delay between filing with the office and recordation; and (c) increasing the information available to searchers, scholars, and the filing office.
  - The staff in the Copyright Office has the technological sophistication to implement such a system if only given the necessary statutory authority and fiscal support.
- Legal Changes—The system should be updated to include the kinds of rules sthat facilitate the ability of developers to obtain financing for their projects.
  - *Filing Rules*
    - A single filing, with a single fee, should be permitted for all assets of a specified party. *If a lender wants a lien in all of the works of Lydgate, one filing should be adequate to perfect against all of them.*
    - Filings should be permitted against after-created assets. *If a lender wants a lien on a work that Lydgate is developing, it should be able to file before*

the work has been created and remain protected throughout the process of development.

- To accomplish this, the Copyright Act should allow filings with constructive notice effect against interested parties ("author/person index") as well as against a work. The person and work files can then be related through a relational database. This is a common approach in industry. For example, telephone contact databases ("electronic Rolodexs") are done this way.
- The records should permit online, electronic filings, searches, and payment. The system also should provide filers and searches contemporaneous verification against existing records to limit typographical errors, as well as substantially immediate confirmation of filings and priority.

— *Priority Rules*—The Copyright Act must clearly define the boundaries of federal preemption of the state filing systems.

- A federal filing should be required and sufficient for any transaction in which a lender attempts to acquire a security interest in a right to exercise any of the exclusive rights protected by the Copyright Act. That should be true whether the right is granted by the owner of the copyright or by some party acting under an exclusive license from the copyright owner.
- A federal filing should not be required for a transaction involving transfers or security interests in purely monetary interests, even if they derive from the copyrighted material. In other words, the priority of a transfer of a right to receive royalties ("accounts") only, independent of any of the exclusive rights in the copyrighted work itself, should be governed by non-federal law. A transfer of rights and royalties, however, should be covered by a federal filing.
- The 30-day and 60-day grace periods in Copyright Act Section 205(d) should be eliminated. That is a vestige of a time when filing paper documents required significant administrative time and effort. An electronic filing system should provide for substantially contemporaneous filing.
- The Copyright Act also should validate the right of the nonexclusive licensee to grant to the lender the right to terminate the right of the licensee to use its software. It is not clear that state law has the power to validate that transaction.

MEMORANDUM—JUNE 20, 1999

To: Joint Task Force of Security Interests in Intellectual Property
Ad Hoc Committee on Security Interests (Business Law Section) Committee 457 (IP Section)
Fr: Lorin Brennan
Re: *Proposed Federal Intellectual Property Security Act*

EXECUTIVE SUMMARY

This Memo comes in response to the fax of November 19, 1998 containing the Revised Draft of the Proposed Federal Intellectual Property Security Act. In essence, the Revised Draft continues to propose a mixed system in which federal law determines priority for the intellectual property rights, but state law determines priority with respect to royalties ("proceeds").

I led the coalition of banks, copyright owners and labor organizations that opposed this proposal when it was suggested to Congress several years ago. I also voted against the proposal in Committee 457 last year. My opinion has not changed.

My objection to a "mixed system" is not that it is difficult to make such a system work; it can *not* work. A "mixed system" is based on a flawed data design. It will invariably lead to data anomalies, including circular liens and searching conflicts. A correct approach requires implementing a relational data model in a unified federal system with constructive notice from both the author ("entity") index and work ("object") index.

The following Memo describes these issues in detail.

ANALYSIS

A. Why a Mixed System Will Fail

Section (b)(2) of the Proposed Federal Intellectual Property Security Act contains the basic "mixed system" approach regarding what it calls "Federal IP Rights," *e.g.*, copyrights, trademarks and patents.

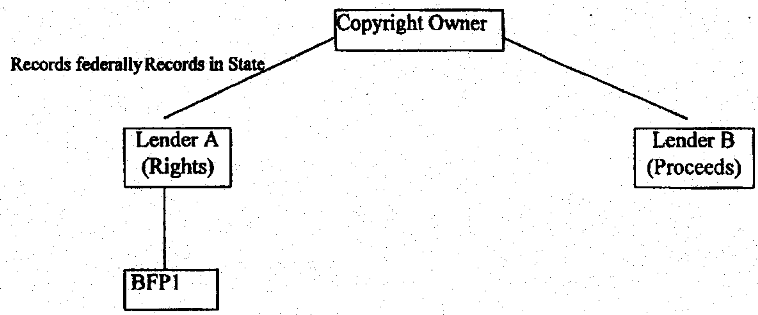
Under subsection (A), ". . . the priority of a security interest in Federal IP Rights or the proceeds thereof relative to all competing rights, claims and interests therein and licenses thereof" is determined by "non-federal law governing security interests in personal property," presumably Article 9 of the Uniform Commercial Code, as currently existing or as revised.

As an exception, under subsection (B), a security interest in a Federal IP is "ineffective against the buyer[1] of the Federal IP Right who properly recorded the document transferring ownership of the Federal IP Right to such buyer . . . before a federal financing statement . . . was filed." In other words, prior filing of a federal financing statement is effective against a subsequent transferee with regard to the rights but not the proceeds.

Let us see how this would work in practice.

1. First Problem: Circular Liens

Assume Copyright Owner grants a security interest to Lender A in a work and its proceeds. Lender A duly records a federal financing statement in the Copyright Office, but no where else. Seeing this, Copyright Owner grants a second security interest in the same work and its proceeds to Lender B, who only records in the state offices. Lender A forecloses and transfers its entire interest to BFP1, a *bona fide* purchaser without actual notice of Lender B's state recording. We can graphically illustrate this example as follows:



Now, what are the rights of BFP1 vis-à-vis Lender B? In particular, is BFP1 required to pay any royalties ("proceeds") to Lender B? Asked another way, if BFP1 refuses to pay royalties to Lender B, what remedies does Lender B have? There are two possible results.

Case 1: BFP1 takes free and clear of the obligation to pay royalties to Lender B. That means when BFP1 exploits the work and earns income, for example by selling copies or making further sublicenses, BFP1 does not owe any payments to Lender B. The argument in favor of this approach is that BFP1 now has legal ownership of the work, and one of the basic incidents of legal ownership is the right to turn it to account. If this is the result, then Lender B did not gain much by making a state recording for the proceeds only. If a transfer to a *bona fide* purchaser who does not have actual knowledge of the state recording cuts off the right to proceeds, then Lender B would be well advised to record federally as to the rights as well.

Case 2: BFP1 takes subject to the obligation to pay royalties to Lender B. In other words, BFP1 still gets the rights, but now must pay a portion of any income to Lender B to pay off the debt. The theory here is that BFP1 has constructive knowledge of the state recording by Lender B.[2] But if that is the case, then BFP1 will

[1] There is no concept of a "buyer" as such in current federal law. The Proposed Federal Intellectual Property Security Act essentially defines a "buyer" as any transferee of IP rights. Under current law, assignments and exclusive licenses are assignable, while non-exclusive licenses are not. Moreover, there is no federal recording system for non-exclusive copyright licenses. As a result, it may be appropriate to treat non-exclusive licenses differently.

[2] We discuss why this assumption of constructive knowledge is not always reasonable in the next section.

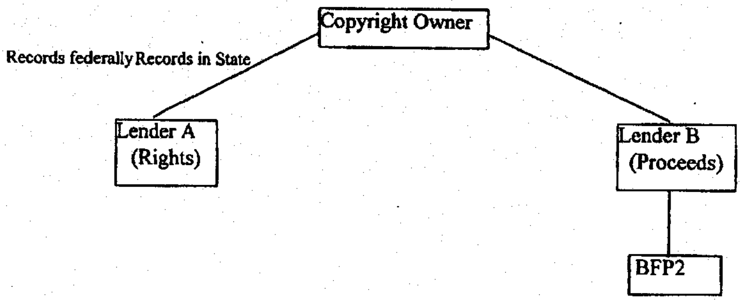
certainly discount its bid in the foreclosure sale based on the obligation to Lender B. That means that if Lender A wants to ensure it gets full value upon a foreclosure, it had better record in the state as well.

We have discussed the example in terms of a *bona fide* purchaser (technically, a *bona fide* transferee) at a foreclosure sale, but the same reasoning applies to a *bona fide* transferee from Copyright Owner as well.

Three observations come from this example. First, the cases are not reconcilable. You get one or the other, but not both. Second, the Proposed Federal Intellectual Property Security Act does not tell us which result is correct.[3] In other words, we will have more litigation over which system prevails in case of conflict. Third, the only secure approach for either Lender is to record in both places, federal and state. Whether such a dual filing system does anything more than create a trap for the unwary will be discussed below.

2. *Second Problem: Incompatible Obligations*

Assume the same example as in the previous case, only this time Lender B forecloses first and transfers its entire interest to BFP2, a *bona fide* purchaser without actual notice of Lender A's federal recording. We can graphically illustrate this example as follows:



Now, what are the rights of BFP2 vis-à-vis Lender A? In particular, is Lender A required to direct any payments it receives from Copyright Owner to BFP2? Asked another way, if Lender A refuses to do so, what remedies does BFP2 have? Again, there are two possible cases.

Case 1: Lender A is required to direct payments to BFP2. In this case, the payments would have been royalties and other income earned by Copyright Owner from exploiting the work, which could have been paid to Lender A either directly by Copyright Owner's licensees or through Copyright Owner. The theory is that BFP2 by the foreclosure now "owns" such royalties. If this is the result, then Lender A did not get what it thought it was getting by making a federal recording for the rights only. If Lender B's transfer to a *bona fide* purchaser who does not have actual knowledge of the federal recording cuts off the right to proceeds, then Lender A would be well advised to record in the state as to the proceeds as well.

Case 2: Lender A is not required to direct payments to BFP2. The theory here is that the royalties come from exploitation of the work by Copyright Owner. If Lender A is deprived of the royalties, then it can foreclose for non-payment and take the work, in effect putting us back in the first situation discussed above. Again we are faced with the question: if Lender A (rights branch) refuses to pay royalties, then what remedy does BFP2 (proceeds branch) really have? BFP2 cannot foreclose on the income-earning asset (the rights), because it does not own them. In such a case, BFP2 will also certainly discount its bid in the foreclosure sale based on the obligation to Lender A, meaning that if Lender B wants to ensure it gets full value upon a foreclosure, it had better record federally as well.

As in the first situation, the Proposed Federal Intellectual Property Security Act does not indicate which case prevails, so the cautious lender would be well advised to record in both the federal and state registers. Once again, the same reasoning applies if Lender A is a licensee.

As these examples illustrate, a dual filing system that splits works from royalties is unstable. Invariably one system must swallow the other.

[3] The same arguments as were made in *Peregrine* and *AEG* would argue for the first approach, meaning that the proposed legislation accomplishes little, if anything.

3. *Third Problem: Searching*

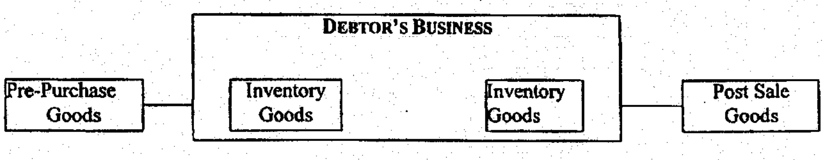
As the previous examples illustrate, the only rational approach for a secured creditor under the Proposed Federal Intellectual Property Security Act is to file in both the state and federal registers. This actually makes matters worse.

The *sine qua non* for filing is to perfect the security interest and thus obtain priority over other creditors, especially a trustee in bankruptcy. Under current law, one filing in one forum, such as filing in the Copyright Office, is sufficient. Requiring two filing now creates a trap for unwary creditors, who may find themselves unperfected as to a critical aspect of their security. Rights and royalties go hand in hand; to separate them for filing purposes invites potential disaster.

Separation also creates a considerable problem when it comes to searching. A secured creditor wants to locate all prior security interests in the collateral. Under current law, that requires, at least for copyrights, one search in the Copyright Office with regard to the work. The Proposed Federal Intellectual Property Security Act would now require two searches, one at the federal level for the rights, and another at the state level for proceeds. Such a search becomes enormously difficult for many copyrighted works, often requiring searches of numerous potential debtors whose domiciles are unknown.

To understand why this is so, we need to look at two different concepts of how financing of intellectual property occurs. We may term them "inventory financing" and "asset financing."

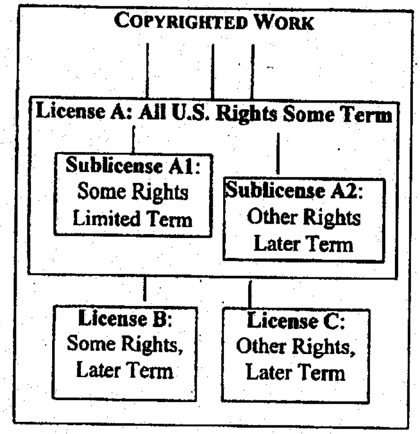
Inventory Financing: In inventory financing, the creditor seeks a floating lien over all the assets of the debtor. Physical objects ("goods") come into and move from the debtor's business, and the lien attaches as the goods enter, and is released in favor of the buyer in the ordinary course as the goods leave. What the creditor looks to is the business of the *debtor*, not the individual objects that come and go, and so, naturally, the security interest is indexed against the debtor. This is the focus of state law recordings under Article 9. We might think of inventory financing as "horizontal financing," graphically illustrated as follows.



In the modern economy, a valuable component of the debtor's assets may consist of software, trademarks and other intellectual property. One would therefore like a floating lien to attach directly to the intellectual property without the necessity of separate filing in a federal register each time the intellectual property becomes part of the debtor's asset base. Note that for copyrighted works, we are really only addressing assignments and exclusive licenses, since there is no federal recording system for non-exclusive copyright licenses.

This is the primary reason for the objections to *Peregrine* and *AEG*. They require additional effort for a secured creditor to perfect its interest under this model. But this is not the only financing model. There is another one in common use for which *Peregrine* and *AEG* are the right answer.

Asset Financing: In this model, the primary focus is not on the debtor's business but on the protected work. We might think of it as akin to real estate financing of an office building. The key asset is the land and the building, and one files a mortgage against the property. In a building, there can be many leases that pay rents (royalties) to the owner. The lender wants to know that filing against the underlying property also gives it priority as to subsequent lease interests. Lending against copyrighted works follows the same paradigm, especially for motion pictures. The underlying property (*e.g.* copyright in the motion picture) can be subject to many sublicenses. A secured lender wants to ensure that filing against the underlying property gives priority as to subsequent licensees. We might think of asset financing as "vertical financing" graphically illustrated as follows.



In this model, each license generates royalties ("proceeds"). By filing against any box, the secured lender gains priority over all included ("junior") boxes. Therefore, a secured creditor loaning against Sublicense A2 to needs to look up the tree to determine whether there is a filing for a prior transferee, *i.e.* with respect to License A or the Copyrighted Work.

Notice that in the horizontal inventory model, there is only one look-up step to the immediate debtor. It is easy to search, since the creditor knows who the debtor is. But in the vertical model, the secured creditor needs to look at all prior interests. The secured creditor may know its immediate debtor, but what about prior transferees?

Here is an example based on real filings for the motion picture *Latino*. The Producer of the picture granted certain exclusive distribution rights to Management Company Entertainment Group, Inc. The Copyright Report discloses that a Pledge and Security Interest was filed in the Copyright Office on July 13, 1989 in favor of Kidder, Peabody Group, Inc., as secured creditor, listing the following companies as debtors:

> Management Company Entertainment Group, Inc., Manson International, MCEG Productions, Inc., Independent Production Resources, Inc., Independent Screenplay Development Corp., MCEG Development Corp., DAHL, Inc., Go Ahead . . . Bore Me, Inc, Plantation House, Inc., Stroke of Luck, Inc., World Food Resources, Inc., Small Minds, Inc., I'm Nothing, Inc., Hometown Boy, Inc., Follow Your Dream, Inc., Redblood, Inc., Beyond Control, Inc., MCEG/Virgin Holdings, Inc., Virgin Vision America, and Virgin Vision, Inc.

This type of filing is not unusual. Motion picture companies typically create many subsidiaries for specific purposes. For example, each picture is often produced by a newly formed company without antecedent debt so that all the capital of the company can be used to produce the picture and will not be attached by prior creditors. Thus, secured lenders often file against all companies in the corporate group.

Assume Lender A now wants to make a loan to the Producer of *Latino* secured by the copyright in the picture including royalties payable. How can Lender A determine what interest has been granted to Management Company Entertainment Group, Inc. and its related companies through a search of the records?[4] Currently, the Copyright Report is sufficient, as it identifies the rights granted to these parties in a single listing, but since it will not be available to us under the Proposed Federal Intellectual Property Security Act, using it would be cheating. Interested parties are invited to determine for themselves what interest, if any, the listed companies have by conducting UCC searches for themselves. No, I do not know where these companies are domiciled. I will also note that there are probably hundreds of UCC–1s filed against Management Company Entertainment Group, Inc. in California alone; which one relates to *Latino* will require reading each one. Of course, even identifying these companies required a Copyright Search. If the Producer had grant-

[4] Obviously, this information can also be obtained from the debtor, but the point of searching the public records is to verify the debtor's representations rather than accepting them on blind faith.

ed rights to Management Company Entertainment Group, Inc., but had granted proceeds to, say, Virgin Vision, Inc., how would Lender A even know about this grant if Producer was not forthcoming?

That is the easy case. At least one can ask the Producer and hope for a complete answer. The Copyright Report for *Latino* also shows that Management Company Entertainment Group, Inc. granted rights to Orion Pictures Corporation. Now, assume Lender A wants to extend credit to Orion based on the value of its assets. Lender A wants to know what prior interests exist with regard to these assets. Orion may know that it obtained rights from Management Company Entertainment Group, Inc., but it may know nothing about, say, a separate assignment of proceeds to Virgin Vision, Inc. Even if Lender A asked and Orion answered honestly, Lender A might not find out. If Producer is unforthcoming or simply unavailable, Lender could not search by debtor with regard to prior grants of proceeds because it does even know who the prior debtor are.

By splitting filings of rights from royalties, the Proposed Federal Intellectual Property Security Act seriously undercuts the ability IP owners to engage in asset based financing of IP rights. Licenses of intellectual property rights can be either exclusive or non-exclusive. For exclusive licenses, the licensee typically undertakes further exploitation of the work through sublicenses or disposition of copies. It is crucial for a senior lender to know that is security interest against the licensor's rights is prior to and entitles it to royalties from sublicensees, and equally important for financiers of sublicensees to know about prior security interests. This is similar to the position of the lenders against office buildings. The permanent lender wants to ensure that its mortgage against the property has priority against the leases of space in the building, and a junior lender against the property or a leasehold estate needs to know about prior mortgages. Non-exclusive licenses, on the other hand, are typically granted to end users, such as a merchant who uses software in its business. In that case, it would be helpful if a floating against the debtor attached to the non-exclusive license. Yet under federal law non-exclusive licenses are not assignable, so even if the lien did attach, it could not be assigned to the lender on foreclosure in any case. The Proposed Federal Intellectual Property Security Act does not even address this issue. What it does is undercut the ability of exclusive licensees to continue the traditional financing method that they need in an attempt to enable a financing method for non-exclusive licensees that they can not use.

The federal filing system, at least for copyrights, looks to the work as the main determinant of value. From this perspective, it quite correctly indexes filings against the work, and it supports well "vertical" asset financing. The decisions in *Peregrine* and *AEG* are correct from this perspective. The Proposed Federal Intellectual Property Security Act only looks at financing from the inventory model. It criticizes *Peregrine* and *AEG* for not supporting this methodology. This criticism is misplaced. The proper course is to develop a filing system that supports both methods.

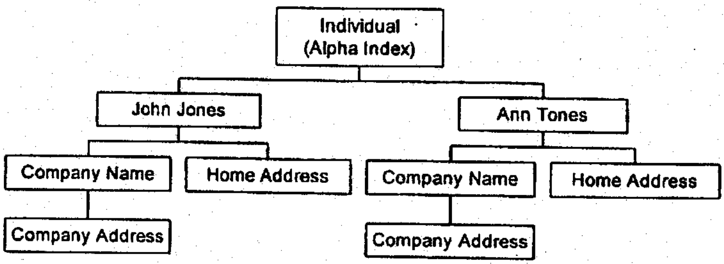
B. The Proper Approach: The Relational Data Model

The previous section gives examples of where a mixed system will fail. But proper analysis requires more than a list of problematic cases. We must also ask why the system fails. The answer is a faulty data model. Essentially, the mixed system proposes a hierarchical data model with two roots (technically, a network model). Such a data model cannot ensure consistency or integrity in the data model itself. Let's see why.

1. The Hierarchical Data Model

Consider a simple example, which we might call the "Rolodex Problem." A Rolodex creates a hierarchical database arranged alphabetically and indexed either by individual ("entity") or by company ("object"). A hierarchical database is often represented in a tree-view as follows:

Hierarchical Rolodex Database



In this case, the database is indexed by individual. One searches the database by "walking the tree" from the root down each branch until the desired data node is reached

As anyone who uses a Rolodex knows, there are problems with this approach. You receive a business card from a client. How do you file the card, by individual name or company name? If you file by individual name, what happens when you want to visit a particular company and all your contacts there? The only way to find all the contacts is to search through all the cards. What happens if an individual leaves a company? If you throw away the card, you lose information about the company. What happens if you file everything by company? How can you find an individual if you forget the company name? Maintaining two databases, one for individuals and one for companies, doubles the filing work, and risks having inconsistent databases (lack of data integrity). The fact is there is no satisfactory solution to these problems using a hierarchical database. The model itself is inadequate to the task.

2. The Relational Data Model

The proper solution to the Rolodex Problem is to implement an entirely different data design, the relational data model. Unlike hierarchical models, which are based on an *ad hoc* data model, the relational model is based on a consistent underlying mathematical theory derived from predicate logic. In simple terms, all data is expressed in tables consisting of rows and columns. These tables are related through a key column that uniquely identifies each row. The Rolodex Problem is solved by maintaining three tables like this:

Person Table

Person ID	Person Name
P1	John Jones
P2	Ann Tones
P3	Pete Clones

Company Table

Company ID	Company Name
C1	Acme Co.
C2	Widget Co.
C3	Blackacre Co.

Person/Company Table

Person ID	Company ID
P1	C1
P2	C1
P3	C2

One table holds the data for persons, another for companies. A third table relates persons to companies. The Person/Company Table identifies that John Jones (P1) and Ann Tones (P2) both work for Acme Co. (C1). Pete Clones (P3) works for Widget Co. (C2). Now, if we want to visit Acme Co. and find all the employees who work there, we just search the Person/Company table for all entries for Acme Co. (C1), and for each entry look to the corresponding Person key and use that to find the entry in the Person table. If Pete Clones moves to Blackacre Co., we simply update the entry in the Person/Company table to indicate the change. We do not need to delete the entry for Widget Co. when Peter changes jobs.

It should be clear that the Rolodex Problem is identical to filing security interests in intellectual property. There are really two different indexes in use. One can record against the owner of the rights, *i.e.*, the person. This is the approach taken in under Article 9, which indexes security interests against the debtor. Alternatively, one can index against the work (company), *i.e.* the IP rights. This is the approach taken under federal law, for example in the Copyright Office, where one records in reference to a registered work. Both state and federal law use single index, hierarchical databases. Both of them lead to the problems commonly found in hierarchical systems. Neither one does or can provide a complete solution by itself.

The Proposed Federal Intellectual Property Security Act adopts the worst solution of all. It requires maintaining two hierarchical databases, with all the problems in that data model, without any method of determining which one prevails in case of conflict. This is like maintaining two Rolodexes with separate data in each one, such as phone numbers in one indexed by name and addresses in the other indexed by company, without any methodology to ensure consistency between them.

It is pointless to argue the merits of inventory financing (Article 9 approach) over asset financing (federal IP approach). Each works fine for its own financing model. Neither one works well for the other. But the universe of IP financing requires we use both. We cannot address this universe by tinkering with either hierarchical model (*e.g.* choosing either state or federal system) or by simply decoupling them (Proposed Federal Intellectual Property Security Act). The underlying data design is wrong. We must move to an entirely new data model.

C. Implementing The Relational Models

In a relational design, we need to maintain two separate tables (registers), one for persons (owners, transferees, secured parties, *etc.*) and another for IP interests (copyrights, *etc.*) The Copyright Office already maintains two such registers now: a work register, and an author register. In concept, we need to amend the Copyright Act to allow constructive notice from filings in the author register, and then give the Copyright Office authority to create a relational database that relates filings between the two. We should start with the Copyright Office as the first step in order to make sure the system functions correctly and then as necessary roll out the system to the P.T.O.

As a design matter, we would not be working on new ground. The World Intellectual Property Organization maintains an International Register for Audiovisual Works.[5] This International Register has been set up on a proper relational model, with two registers, a "person register" and a "work register" with systems to relate filings. W.I.P.O. has already established forms and procedures for its use. The current Registrar of Copyrights spent close to a year at W.I.P.O. working on the International Register and is quite familiar with how these systems should be established.[6] There is of course no need to adopt any of the W.I.P.O. rules or forms, and I am not advocating that we do so. The point is that there is a wealth of knowledgeable talent available at the federal level to implement a proper system.

We should identify in principle what we want the system to do (data design phase) before constructing the legal rules (coding). I suggest the system should do the following:

Single, National System: Article 9 envisions separate state registers. But intellectual property rights under federal law are national in scope. Thus, we need a national database to deal in national rights. It must also be a single database. We cannot maintain two separate databases and ensure data integrity. This argues that the filing structure must be a single, unified federal system.

Relational Data Model: The federal system must implement the relational data model. In other words, the system must allow filings against the work (IP Rights) as well as filings against persons. This will require maintaining a separate "person" index. The system must maintain the relationship between them. The work of the System Manager (*e.g.* Register of Copyrights) is to maintain the database.

Constructive Notice As to Persons: As a legal matter, filings in the person index must also impart constructive notice to establish priority against subsequent transferees. There may need to be a "birth certificate," like a registration certificate, identifying the first filing for a person. This system would greatly simplify such matters as filing corporate name changes, mergers, *etc.*

Floating Liens: The system should allow for filing floating liens. This could be done by filing against an individual in the person index. The system would then attach the filing to all registered works of the debtor.

After-Acquired Property: The system should allow for filings that apply to after-acquired property. The Copyright Act now allows for transfers of works to be cre-

[5] For political reasons we need not discuss here, the U.S. has not adhered to the Treaty establishing this Register, although many countries have.

[6] I was a member of the U.S. Delegation to the Diplomatic Conference that established the International Register, and also spent considerable time working on the project.

ated, although there is no constructive notice effect until the work is registered. This becomes a problem when advancing funds to create a work, such as for software development or motion picture production. Again, filings in the person index can accommodate this approach. We may want a time limit, such as the filing only applies to works registered within X years of the filing date.

Others may have additional suggestions as to how the system should operate, but I suggest that this is the direction discussions should take. Please note that the Copyright Act only has a federal filing system for assignments and exclusive licenses. Thus, this discussion only relates to them. Different considerations may apply to non-exclusive licenses.

CONCLUSION

Intellectual property rights have become the center of the American economy. The IP industries are the faster growing segment of the economy and the engine of new job growth and wealth creation. Continued development in this area requires a modern system for facilitating secured financing.

The relational data model is *the* modern data model. It is the basis for the vast majority of business databases. It is implemented in all the office suites (*Access, Approach, Paradox*) as well a products from major business suppliers (Oracle, Sybase, Microsoft SQL Server). It is the only data model grounded on a solid mathematical foundation.

A modern financing model for IP Rights should be grounded on a modern data model.

Mr. COBLE. Thank you, Mr. Brennan. That bell indicates we have a vote on. Ms. Chasser, why don't we hear from you and then I will go vote and come back if that is okay.

STATEMENT OF ANNE CHASSER, DIRECTOR, OFFICE OF TRADEMARK & LICENSING SERVICES, OHIO STATE UNIVERSITY, ON BEHALF OF THE INTERNATIONAL TRADEMARK ASSOCIATION (INTA)

Ms. CHASSER. Thank you, Mr. Chairman. The International Trademark Association appreciates the opportunity to appear before the subcommittee to comment on the need to reform the system governing security interests and trademarks. America's fast-paced economy is motivated by ideas, information, and technology. To put it another way, it is driven by our intellectual property. Therefore, many consider intellectual property, including a company's trademarks, to be assets in the same manner as a building, a piece of machinery, or a work of art.

Trademarks are often a company's most valuable asset. As a result, trademarks can become collateral to finance a new venture or launch a new product line. In these circumstances, the lender holds a security interest in the trademark. The UCC is not totally effective when dealing with the security interest in a federally registered trademark. The problem lies in the interplay between the State-codified UCC and the Lanham Act. Among trademark practitioners and legal scholars, there is uncertainty as to whether the Lanham Act preempts the State UCC. The UCC states that article 9 does not apply to security interests if the parties' rights to the property are governed by a Federal statute. It also states that if the Federal statute does not address this, then article 9 of the UCC may indeed be looked to for an answer.

So we turn to the Lanham Act. It does not directly address security interests per se. However, it does contain provisions allowing for assignments of trademarks to other parties to be recorded. When all is said and done, the Lanham Act has generally been interpreted not to be a Federal statute that preempts article 9, although the case law is far from being consistent on this issue. The result is widespread legal uncertainty for intellectual property owners and also for purchasers of business in which intellectual property is an increasingly valuable part of the transaction.

The practice, which has evolved among trademark practitioners, is to record the security interests at the State level under the UCC and also record a copy of it with the U.S. Patent and Trademark Office. Unfortunately, this practice does not always work due to the ambiguities of the recording security interests under section 9 of the Lanham Act. In fact, this practice has often led to disastrous outcomes, the loss of trademark rights and their value as collateral.

What this amounts to, Mr. Chairman, is a troubling lack of certainty as to how to perfect a security interest in trademarks. In other words, how do you put other parties on notice that the interest in the trademarks exist?

This ambiguity has negative repercussions for trademark owners, lenders and potential purchasers.

Mr. COBLE. Ms. Chasser, if you will, hold that thought. Let me proceed to the floor.

You all stand easy in the interim, and I will return imminently.

[Recess.]

Mr. COBLE. I apologize to you all. The best laid plans of mice and men go awry. The vote that was to have been about 30 minutes from now was accelerated. I thought, rather than come back and return to the floor, I would just stay over there.

So thank you all for waiting. Ms. Chasser, are you still holding that thought?

Ms. CHASSER. I am holding that thought.

Mr. COBLE. You may continue.

Ms. CHASSER. We were talking about the ambiguities in the recording of security interests.

There is one promising answer, and that is a proposal to establish a national uniform recordation system for tracking security interest in trademarks. Under this approach, security interests are filed under section 9 of the UCC in the applicable State, but then they are also supplemented by a new notice filing at the Federal level. This allows potential purchasers to check only the Federal database rather than resorting to guesswork or conducting time-consuming searches of all fifty States for a UCC filing.

This is a straightforward method that utilizes the UCC apparatus already in place and is familiar to lenders, borrowers and purchasers in the commercial world. Yet it also integrates the existing Federal registration system.

By reconciling these two established systems, this approach will provide an effective mechanism for recording interests in trademarks.

The benefits for all parties of a central database will not be realized, however, until the 3-month grace period for filing an assignment under section 10 of the Lanham Act is eliminated. This will encourage prompt recording of security interests so that prospective purchasers of the trademark will have timely notice of security interests in the property.

To conclude, Mr. Chairman, I want to thank you again for this opportunity. INTA remains committed to working with you and others in the intellectual property community toward workable security interest legislation.

Thank you.

Mr. COBLE. Thank you, Ms. Chasser.

[The prepared statement of Ms. Chasser follows:]

PREPARED STATEMENT OF ANNE CHASSER, DIRECTOR, OFFICE OF TRADEMARK & LICENSING SERVICES, OHIO STATE UNIVERSITY, ON BEHALF OF THE INTERNATIONAL TRADEMARK ASSOCIATION (INTA)

SUMMARY

Today, in an economy driven by technology, information and ideas, trademarks and other forms of intellectual property may very well be the most valuable asset a company owns. As a result, trademarks can become collateral to finance a new venture or launch a new product line. In these circumstances, the lender holds a "security interest" in the trademark. The current legal framework for security interests is Article 9 of the Uniform Commercial Code or "U.C.C." as codified in the laws of the individual States.

Unfortunately, however, the U.C.C. is not totally effective when dealing with a security interest in a federally registered trademark. The problem lies in the interplay between the state-codified U.C.C. and the Lanham Act, the federal statute governing trademarks. No one can really say for certain whether or to what extent the Lanham Act preempts the state U.C.C.

The U.C.C. says that Article 9 does not apply to a security interest if the party's rights to the property are governed by a federal statute. Yet, it also says that if the federal statute does not contain relevant provisions, then Article 9 of the U.C.C. may indeed be looked to for an answer. Turning then to the Lanham Act, it does not directly address security interests per se. However, it does contain provisions allowing for "assignments" of trademarks to other parties to be recorded. When all is said and done, the Lanham Act has generally been interpreted NOT to be a federal statute that preempts Article 9, although the case law is far from being uniform on the issue. The result is widespread legal uncertainty for intellectual property owners and also for purchasers of businesses in which intellectual property is an increasingly valuable part of the transaction.

One promising answer is the proposal to establish a national, uniform recordation system for tracking security interests in trademarks. Under this approach, security interests are filed under Article 9 of the U.C.C. in the applicable state , but then are also supplemented by a new notice filing at the federal level. This allows potential purchasers to check only the federal database rather than resorting to guesswork or conducting searches of all 50 states for a U.C.C. filing.

This is a straightforward method that utilizes the U.C.C. apparatus already in place and familiar to lenders, borrowers, and purchasers in the commercial world. Yet, it also integrates the existing federal registration system. By reconciling these two established systems, this approach will provide an effective mechanism for recording interests in trademarks.

The benefits for all parties of a central database will not be realized, however, unless the three-month grace period for filing an "assignment" under Section 10 of the Lanham Act is eliminated. This will encourage prompt recording of security interests so that prospective purchasers of trademarks will have timely notice of security interests in the property.

INTA is looking to remove the uncertainty that has prevented trademark owners from being able to realize the full value of their trademark rights in secured lending transactions. INTA remains committed to working with the Subcommittee, as well as others in the intellectual property community towards workable security interest legislation that safeguards the rights of trademark owners.

STATEMENT

Introduction

Good afternoon, Mr. Chairman. The International Trademark Association ("INTA") appreciates the opportunity to appear before the Subcommittee to offer its comments on the need to provide greater certainty and uniformity in the treatment of security interests in trademarks. My goal here today is to inform you about the problems trademark owners face under the current security interest system and then present you with possible solutions. We anticipate that this hearing will likely be the first step in a series of discussions on this subject and look forward to continuing to work with the Congress and other interested parties. My name is Anne Chasser. I am the President and Chairperson of the Board of Directors of INTA.

Today, in an economy driven by technology, information and ideas, intellectual property may very well be the most valuable asset a company owns. Like other forms of business property, it can provide valuable collateral to finance a new venture or launch a new product line. Yet, the law governing security interests in intellectual property has not kept pace with the changing economy. To begin with, it is unclear which laws—the state-codified Uniform Commercial Code (U.C.C.) or the federal intellectual property statutes—provide the greatest protection and certainty for intellectual property owners and their business partners. In practical terms, the confusion results in significantly increased transaction costs, creates uncertainty with respect to priorities in secured transactions, reduces the value of intellectual property and in some cases forecloses the access of intellectual property owners to much needed capital.

Trademarks and Security Interests

Trademarks are among the most significant assets of a company—an efficient way to convey a message of quality, consistency, safety, and predictability to the consumer in an easy-to-understand form. Equally important, trademarks are the impetus for an economic transaction that begins with an idea, is translated into productivity, and ends with a satisfied customer.

There are times when a business, regardless of its size, may want to use its valuable trademark(s) as collateral to secure a loan or other obligation. If the trademark owner does not satisfy the terms of that obligation in the future, the lender can foreclose and sell the trademarks to satisfy the debt. In such a case, the trademark is no different from accounts receivable or other intangible assets that are offered as collateral for a loan. The lender is said to hold a security interest, and the primary legal framework for security interests is Article 9 of the U.C.C.

In security interest agreements, it is important to remember that there is no transfer of ownership of the mark(s). Transfer of ownership to the lender is supposed to take place only if the borrower (trademark owner) defaults on the loan. In other words, the security agreement is a conditional assignment.

The U.C.C. and Federal Intellectual Property Statutes

In order to protect its position, the lender will want to let others know that it is "first in line" to take ownership of the mark(s) if there is a default on the loan secured by the mark(s). It also becomes important when the owner of the trademark seeks to sell the business. A prospective buyer will want to know of any security interests in the assets of the business, including its trademarks.

Generally, for a lender to secure its "first-in-line" status, the U.C.C. requires the lender to "perfect" its interest by filing written notice in the appropriate state office (typically the secretary of state), where it then becomes publicly available. While this seems straightforward enough, the U.C.C. system has proven to be inefficient in providing adequate notice of perfecting security interests in trademarks.

This is due to the interplay between the state-codified U.C.C. and the federal statute governing trademarks—the "Lanham Act." For example, the U.C.C. states that the provisions of Article 9 do not apply to security interests to the extent that a party's rights regarding such property are governed by federal statutes.[1] It further provides that a financing statement under Article 9 is not "necessary or effective to perfect a security interest in property subject to (a) a statute . . . of the United States which provides for national registration . . . or which specifies a place of filing different than that specified in this article."[2] Official Comment 1 to § 9–104 of the U.C.C. states, however, that "if the federal statute contains no relevant provision, this Article could be looked to for an answer."

While the Lanham Act does contain a provision allowing for "assignments,"[3] and while the USPTO Assignment Division generally accepts for recordation other documents affecting title, it does not contain any express provision addressing security interests. Thus, the Lanham Act has generally been interpreted *not* to be a federal statute that supersedes Article 9, although the case law is not uniform. The interpretation of the interplay between the Copyright Act or the Patent Act and Article 9 is also inconsistent, leading to even greater uncertainty. Moreover, as one of the leading authorities on trademark law, Professor Thomas J. McCarthy notes,

[1] U.C.C. § 9–104(a).
[2] U.C.C. § 9–302(3)(a).
[3] 15 U.S.C. 1065.

"Lanham Act § 10 can be read to mean that recordation notice is triggered only by recordation of a presently effective assignment."[4]

The Problem for Trademark Owners

Lack of a Centralized System

The problem for trademark owners is that there is no clear federal system for recording security interests in federally registered trademarks or pending applications, particularly as to subsequent bona fide purchasers. At the same time, there is not sufficient case law to conclusively assure trademark owners that a state U.C.C. filing alone will be adequate to put all parties on notice as to a security interest in federally registered marks or pending applications. The result is widespread legal uncertainty for intellectual property owners and also for purchasers of businesses in which intellectual property is an increasingly valuable asset.

The practice which has thus evolved on an ad hoc basis among trademark practitioners is to record a financing statement under Article 9 of the U.C.C. *and* also to record a copy of the security agreement at the USPTO. Nonetheless, many lenders require that trademark owners give up ownership of their mark(s) without ever having defaulted on the loan, because of the ambiguity with respect to recording of conditional assignments such as security interests under Section 10 of the Lanham Act. The lender, now the assignee, then licenses the mark back to the original owner. In this way, the lender believes that it is assured of its "first-in-line" position upon default or when there is a subsequent purchaser.

Unfortunately, however, this practice has had disastrous results. In *Haymaker Sports, Inc.* v. *Turian*[5] and *Clorox Co.* v. *Chemical Bank*,[6] such an assignment and license back was held to have invalidated the trademark registrations assigned to the lender, resulting in a loss of the trademark rights and their value as collateral. If the lenders in these cases had taken a conventional grant of a security interest, the trademark registrations would have been maintained.

What this all amounts to, Mr. Chairman, is a troubling lack of certainty as to where to file and how to perfect a security interest in trademarks, which affects both trademark owners, lenders, and potential purchasers.

The Three-Month Period

In addition to the problems that relate to the lack of a central or single intellectual property security interest system, there is the matter of Section 10 of the Lanham Act, which gives an assignee three months in which to record his interest in the mark with the USPTO. Consider this scenario: During the three month period before the lender is required to file the security interest with the USPTO, the trademark is sold to a bona fide purchaser. The purchaser might immediately have conducted due diligence into whether the mark and registration were, in fact, owned by the seller and not have turned up anything to the contrary. The lender could, in the meantime, file the required documents 85 days after the assignment—within the three-month period—and still walk away with the rights to the mark. The purchaser gets nothing other than what can be obtained in an action for fraud brought against the seller, even though the purchaser had no practical way to confirm ownership of the mark other than the USPTO assignment records.

The Solution

A National Recordation System

One way to create certainty and alleviate problems in commercial transactions involving trademarks is a national recordation system. This will establish a uniform, dependable method for tracking security interests in intellectual property that will benefit trademark owners, lenders, and potential purchasers. It will provide comfort to lenders who want to perfect and give notice of their security interests and in turn permit borrowers who own trademarks to maintain ownership of their property unless they default. Under this approach, security interests would be filed under Article 9 of the U.C.C. in the applicable state and supplemented by a new notice filing at the federal level (on a debtor's name basis) designed to establish priority over subsequent transferees/assignees. State law would continue to govern all priority issues, except that for any lender (or other party) to obtain priority over a later *purchaser*, the lender must have filed at the federal level. This allows potential purchasers to check only the federal database rather than resort to guesswork or conduct a time-consuming search of up to fifty states for a U.C.C. filing.

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[4] J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition*, Fourth Edition, Volume 2 (St. Paul: West Group, 1998) 18–14.

[5] 581 F2d 257, 198 USPQ 610 (CCPA 1978).

[6] 40 U.S.P.Q.2d 1098 (T.T.A.B. 1996).

This is a straightforward method that utilizes the U.C.C. apparatus already in place and familiar to lenders and borrowers in the commercial world. Yet, it also integrates the existing federal registration systems. By reconciling these established systems, the proposed legislation will provide an effective mechanism for recording interests in intellectual property and eliminate the present uncertainty.

Eliminate the Three-Month Period

Elimination of the three month period reduces the chances of a subsequent purchaser of an interest in a registered mark winding up second in line to an assignee that was wholly unknown to the purchaser at the time of the purchase. Furthermore, it encourages prompt recording of the interests and makes it function just like the current state-level U.C.C. and real property recordation systems familiar to both lenders and borrowers.

Conclusion

Trademark owners are seeking reforms which would encourage lenders to record a security interest with the USPTO as notice to potential purchasers of their preexisting rights. The increased certainty should eliminate the requirement imposed by lenders that the trademark owner give up ownership of the mark as a condition of receiving the loan. Such amendments will also facilitate the creation of a nationwide database for security interests not only in trademarks, but patents and copyrights as well.

Thank you again, Mr. Chairman. We applaud your efforts and remain committed to working with you, the members of this subcommittee, staff, and others in the intellectual property community towards workable security interest legislation that safeguards the rights of trademark owners.

THE INTERNATIONAL TRADEMARK ASSOCIATION

INTA is a not-for-profit membership organization, which just recently celebrated its 121st anniversary at its annual meeting in Seattle, Washington. Since the Association's founding in 1878, membership has grown from 17 New York-based manufacturers to approximately 3,600 members from the United States and 119 additional countries.

Membership in INTA is open to trademark owners and those who serve trademark owners. Its members are corporations, advertising agencies, professional and trade associations, and law firms practicing trademark law. INTA's membership is diverse, crossing all industry lines and spanning a broad range of manufacturing, retail and service operations. All of INTA's members, regardless of their size or international scope, share a common interest in trademarks and a recognition of the importance of trademarks to their owners, to the general public, and to the economy of both the United States and the global marketplace.

Mr. COBLE. Mr. Kirk.

STATEMENT OF MICHAEL K. KIRK, EXECUTIVE DIRECTOR, AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION (AIPLA)

Mr. KIRK. Thank you, Mr. Chairman. As we have heard today, intellectual property, or IP assets, are often the major assets of companies, and they are frequently used to secure loans critical to the company's existence and growth. To have a system where there is certainty for both the lender and the borrower greatly increases the value of IP in its role as collateral for loans.

As Ms. Montgomery has outlined for us earlier, the law regarding perfecting of security interest is in some disarray, which creates uncertainty. It is this uncertainty, as well as the inability to include after-acquired rights, that prompted AIPLA to work with others toward achieving a uniform treatment of security interest in all types of IP.

The ABA-drafted bill, FIPSA, in which we have cooperated, while still a work in progress, is a step toward bringing greater certainty into the recording of security interest in Federal IP. Although there are certain aspects of FIPSA that warrant further study, the AIPLA supports a number of its underlying concepts.

We support the concept of permitting a filing at Federal agencies with respect to security interest in Federal IP. We believe these filings should be notice filings made in the name of a debtor and creditor, similar to filings under the UCC. Unlike the Federal filings regarding ownership of Federal IP, there should not be a requirement to identify the specific IP used as collateral, although it could be permitted if desired by either party.

Moreover, we do not believe it necessary that Federal security interest filings include a copy of the actual agreement or contract giving rise to the security interest.

The AIPLA believes that it should also be possible to have security interests cover after-acquired IP of the debtor if that is what the parties agree to. Under the present system, for example, a computer software developer may have difficulty in securing financing based on the projected value of software under development, as Mr. Johnson pointed out in his written statement.

AIPLA also supports uniformity in the various Federal systems for filing security interest or ownership changes involving Federal IP rights. From the standpoint of IP owners, the optimal approach would be to eliminate all look-back provisions in the various systems. Today, for example, the assignee of a patent taking advantage of a 3-month look-back provision in existing Title 35, section 261, to record an assignment can wind up taking the patent subject to a security interest filed in a State earlier during that 3-month look-back period.

Of course, the full benefits of the elimination of the look-back period in existing Federal IP law can only be practically achieved if electronic filing of Federal security interest and ownership documents is implemented. Establishing electronic filing systems will also facilitate electronically searching such filings. A number of States already permit the filing of security interests by electronic means, and several of them also provide for electronic searching of those filings. The software to do this, therefore, has already been developed and is in use in States.

It would be desirable for the various Federal systems to adopt uniform, compatible systems so as to enable simultaneous filing and simultaneous searching across the various systems. The creation of such uniform, interconnected systems should be required as part of any change made by Congress.

As I noted earlier, this is a work in progress. There are many questions yet to be answered, indeed probably many questions that haven't even been asked. Nonetheless we believe that a rationalization of the recording of security interest holds considerable promise, and we plan to work with this committee and with others to achieve a workable solution acceptable to all.

Thank you, sir.

Mr. COBLE. Thank you, Mr. Kirk.

[The prepared statement of Mr. Kirk follows:]

PREPARED STATEMENT OF MICHAEL K. KIRK, EXECUTIVE DIRECTOR, AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION (AIPLA)

Mr. Chairman:

I am pleased to have the opportunity to present the views of the American Intellectual Property Law Association (AIPLA) to the Subcommittee on Courts and Intellectual Property on possible changes to the existing federal systems for recording security interests in intellectual property.

The AIPLA is a national bar association whose nearly 10,000 members are lawyers in private and corporate practice, in government service, and in the academic community. AIPLA members comprise a wide and diverse spectrum of individuals involved directly or indirectly in the practice of patent, trademark, copyright, trade secret, and unfair competition law, as well as other fields of law affecting intellectual property.

Intellectual property assets—patents, trademarks, copyrights, trade secrets, etc.—are often the major assets held by a modern company, and are frequently used to secure loans critical to the company's existence and for growth. Often for individuals trying to start up a commercial enterprise, intellectual property may be the only asset upon which a loan might be based. To have a system where there is certainty for both the lender and the borrower greatly increases the value of intellectual property in its use as collateral for a loan.

The present approach to recording security interests in intellectual property is to use a mixture of federal and state systems. In their administration of the Uniform Commercial Code, the states have embraced a system where intellectual property is handled as personal property and security interests in such personal property are generally perfected by recording with the Secretaries of States. A security interest in some types of intellectual property, however, must be recorded federally in order to perfect that security interest. This is true of copyright. Security interests in intellectual property which has a basis in the laws of the states is solely handled by the states. For example, perfection of a security interest in unregistered trademarks and trade secrets may only be accomplished by a state filing. With respect to a federally registered trademark, however, a federal filing also needs to be made to affect bona fide purchasers for value of such marks. Case law is unsettled regarding perfection of interests in patents, although filing probably must be done federally. It is this melange of uncertainty, particularly in regard to perfecting security interests in the various types of federal intellectual property, as well as the inability to include after-acquired rights, that has prompted an effort to uniformly treat security interests in all types of intellectual property.

These problems have been the subject of a great deal of work over several years, beginning with the International Trademark Association at least as early as the late 1980s and, more recently, by the Joint Task Force of the Business Law and Intellectual Property Law Sections of the American Bar Association. The AIPLA has been active in this effort for the past year. The draft bill resulting from this effort, the "Federal Intellectual Property Security Act," advances the IP community toward the goal of a more integrated and rationalized security interests recording system at the federal level. While still a work-in-progress, it is a beginning toward bringing greater certainty into the recording of security interests in federal intellectual property.

The AIPLA supports the concept of permitting a filing in federal agencies with respect to security interests in intellectual property. We believe these filings should be notice filings, similar to those used in states under the Uniform Commercial Code. These federal filings should also be made in the name of the debtor and the creditor. Unlike the federal filings regarding ownership of federal intellectual property, it should not necessarily require a specific identification of the intellectual property being used as collateral, although it should permit the filing to be limited to specific intellectual property if desired by either party. Moreover, federal security interest filings should not require the filing of the actual agreement or contract giving rise to the security interest.

The AIPLA also supports a system where it is not only possible to generically identify the intellectual property that is the collateral for the security interest, but to also have the security interest cover after-acquired intellectual property of the debtor, if that is the agreement of the parties. Under the present system, for example, computer software developers and book publishers may have difficulty in securing financing based on the projected value of software under development or books not yet written.

The AIPLA supports uniformity in the various systems for filing security interests or ownership changes involving federal intellectual property rights. From the standpoint of intellectual property owners and lending institutions, the optimal approach would be to eliminate all look-back provisions in the various systems. With the existing look-back periods in federal systems for recording ownership changes, a bona fide purchaser for value taking advantage of a look-back provision could be seriously disadvantaged. For example, an assignee of a patent taking advantage of the three-month look-back provision in existing 35 U.S.C. §261 to record his or her assignment may end up taking the patent subject to a security interest in the patent filed in a state earlier in the three-month period. Of course, the full benefits of the elimination of the look-back provisions in existing law for patents, trademarks and copyrights could only be practically achieved, however, if electronic filings of federal security interest and ownership documents is implemented.

If security interests in and ownership documents for intellectual property could be filed electronically, all concerned would benefit. This would include the financial institution making loans with intellectual property as collateral, the intellectual property owner using the intellectual property as collateral for a business loan, and the public. Establishing a system for electronically filing federal security interests and ownership documents would also facilitate the creation of a system for the public to electronically search all the filings. A number of states already permit the filing of security interests by electronic means and several of them also provide for electronic searching of their collection of security interest filings.

Further benefits could be achieved by having uniformity among the federal systems for security interest filings and ownership recordation so as to enable simultaneous filing and simultaneous searching across the various systems. The ability to electronically access numerous systems would achieve many of the benefits of a centralized system. This would enable a person to simultaneously electronically file a security interest in intellectual property in numerous offices. Likewise, one could readily search the various federal agencies for information regarding a security interest recorded in regard to a given debtor or information about a given intellectual property owner, or to obtain ownership information regarding a specific copyright or patent.

When the exercise to improve the system for recording security interests in intellectual property was started, the electronic filing, record keeping and searching option for such records was not possible. Now that it is possible, automating the process in this manner should be considered and made part of any accommodation or change suggested for individual systems. Consideration of the electronic filing, record keeping and searching option will undoubtedly be part of the study to be undertaken by the Franklin Pierce Law Center regarding the feasibility of establishing a centralized intellectual property registry. The study, which is referred to on page 83 of Senate Report 105–235, will involve assessing and defining the technical, economic, and legal requirements associated with a centralized registry.

As indicated earlier, the draft bill is a work-in-progress. There are many questions yet to be answered and a number of issues yet to be resolved. For example, the funding necessary to establish electronic systems for the filing of federal security interest statements needs further study, and it is likely that the Patent and Trademark Office and the Copyright Office will have to be authorized to administratively set the fees for both financing statements as well as assignments to fund the system. Moreover, some Congressional direction will likely be necessary to achieve the desirable coordination and implementation of the electronic filing and searching systems by the respective Offices. Nonetheless, the effort holds out considerable promise and we intend to continue our efforts to achieve a workable solution.

Mr. COBLE. As usual, you beat the red light. You know, when you start recognizing people in the audience, you inevitably are going to miss somebody, and I omitted John Canton and Hayden Gregory. I see Paul is still back in the corner. Ben left us earlier.

Remember me to him, if you will, Paul.

Thank you, folks, for your contribution today.

Ms. Montgomery, the ABA proposal would permit the same type of notice filing used in filing security interests at the State levels to be used in filing security interests with the Federal agency.

Would this change the type of documents and information contained in those documents filed with the Copyright Office regarding matters of ownership and title to a copyrighted work?

Ms. MONTGOMERY. No, but I had better explain why I say that.

Mr. COBLE. Okay.

Ms. MONTGOMERY. This does not call—the ABA proposal does not call for any changes with respect to documenting ownership of a copyrighted work, ownership of a trademark or ownership of patent, and it doesn't change where you look to determine who the owner is. You still look in the Federal Registry. What this calls for is, if the owner of one of these types of intellectual property gives a security interest in order to secure a loan or some other obligation, that in order for the secured party to perfect its interest against other secured creditors—not somebody who might come along and buy it, but other lenders, other secured creditors, a trustee—for that purpose, you would make a notice filing at the State level.

At the Federal Registry, that security interest filing would be made at the Federal level, and that would give notice to any subsequent buyer, licensee, anybody else who searched the Federal record and wanted to know not only who are the owners but who might be claiming a lien or some other encumbrance on the title. So it will, in fact, provide more information than is available now.

Mr. COBLE. I have another question for you, Ms. Montgomery. I will come back to you.

Mr. Johnson, how do you respond to the fact that copyright owners, particularly the software industry, have not been overly vocal about a need to reverse *Peregrine* or even enact a more comprehensive system of filing, such as that suggested by the ABA?

Mr. JOHNSON. Mr. Chairman, I think many of the smaller companies that are in the business of software development have many, many things on their plate, including obtaining financing for their businesses, which are generally small, smaller and undercapitalized. I am not sure that they are, as a group, as well organized and have focused on this issue of how these rulings have perhaps inhibited their ability to get financing.

I am aware of a number of situations, both firsthand and from other members of our trade association, where the process of documenting our security interest has been time-consuming and cumbersome, to software developers in particular, but I really don't have an explanation as to why they haven't been more vocal at this point.

Mr. COBLE. Mr. Brennan, let me put that same question to you. Do you have an idea or a thought as to why we have not heard more from copyright owners?

Mr. BRENNAN. I have had a talk with several of the trade associations in the software area, Mr. Chairman. As you know, we have been advocating doing changes in this area in my association for some time. We would like to be able to cover after-acquired property, including liens, and I have talked to the software industry. So far, the representatives have told me that generally they fund their companies by equity, not by debt instruments, and so they are not too interested.

Our industry was perhaps that way when the new technology was video back in the early 1980's, and we found that at some point you go to instruments. So I would think at some point the software industry may be interested in more secure financing for their assets.

Mr. COBLE. Ms. Chasser, do you have any recommendations on how to improve and/or change the ABA or CFA proposals?

Ms. CHASSER. The INTA is interested in the clarity, uniformity and simplicity of the legislation, and we look forward to working with the ABA and others in the IP community toward improvement of the legislation.

Mr. COBLE. Thank you.

Mr. Kirk, the ABA's, quote, "mixed approach," close quote, of filing security interests at the State level and recording any information dealing with ownership and title of intellectual property at the respective Federal agency would probably involve a large start-up cost for the Federal agencies. What is the ABA's position, if you know, on making the proposed Federal recordation system funded by user fees?

Mr. KIRK. Mr. Chairman, I will answer only for AIPLA.

Mr. COBLE. I'm sorry, not ABA.

Mr. KIRK. AIPLA would support giving the authority to both the Register of Copyrights and to the Commissioner of Patents and Trademarks to establish administrative fees to offset the cost of filing these Federal financial statements at the Federal level. We believe that it should be done electronically, as I mentioned. The States are doing this. We know that it can be done.

We recently observed, for example, in the World Intellectual Property Organization that if you file patent cooperation treaty documents using their electronic filing system, they will reduce your cost by—your fees by $140 per transaction.

So, yes, there will be some start-up costs, we can't deny that, but long term, it will be a savings to users, and particularly in the Patent and Trademark Office, once you get your bill H.R. 1907 passed with the Public Advisory Committee to oversee, to make sure they do it the right.

Mr. COBLE. And that is $140?

Mr. KIRK. The cost savings in the World Intellectual Property Organization with respect to the filing of patent cooperation treaty applications. If you choose to file strictly in paper with them, then your filing fees are a fixed amount; however, if you choose to file using their electronic filing system, which has cover documents that would probably be much more involved than the UCC-1-type notice arrangement here, if you choose to use their electronic filing for those cover sheets, which allows you to automatically determine whether there are errors—for example, if you leave a field out, the form is bounced and it says, hey, dummy, fill in this blank, you left it blank.

So if you follow that format and file electronically, they will reduce your fees, reduce your fees by $140.

Mr. COBLE. Ms. Montgomery, much can be said about body language or facial response, and I noticed your facial response when Mr. Brennan was testifying. It was not necessarily adversarial, but do you want to respond to that?

Ms. MONTGOMERY. Thank you, Mr. Chairman. I would.

I think with respect to—he gave two very interesting and useful examples in his presentation, and the first one, you might remember it, was a contest between a secured party and a subsequent exclusive licensee, and the question was, who wins; and that is exactly one of the situations that is not clear now and would be very clear under FIPSA.

As long as the secured lender filed notice filing at the Federal level, then it would be clear. So that is exactly one of the situations we are trying to resolve.

With respect to the search example, it is—you know, it is difficult to—people talk about how technical an area this is, and it is not easy to understand; and it is easy in that kind of area to pick a technical example that creates a great deal of concern about costs.

But I think there are a couple of things I can say about the example he gave for Terminator 2 that might at least put it in context. One, I think he failed to admit what—to consider what, to me, and I think many, would be a very, very important intellectual property asset in that arrangement. Not only would someone making Terminator 3 want to make sure they had sufficient license from prior copyright owners to create a derivative work, but I think they would be very interested in knowing that they had a trademark license for Terminator, and that they had it from the right party; and if they took an interest in it, in order to cover the funding, that they properly perfected it.

Well, with respect to the trademark right now, they would have to face State filings, State searches, and they would also have to look in the trademark Office. Because of the insecurity in the trademark area, as Ms. Chasser alluded to, many lenders aren't comfortable, and so if you try and use your trademark as an asset in this area as collateral, some lenders will require not a security interest, but that you actually transfer ownership, and that they can then record a transfer of ownership in the trademark Office; because under the Lanham Act, they are clear what the effect of that kind of filing is.

So in the Terminator example, you are going to be doing all those State filings anyway, all that State searching anyway.

On the other hand, I want the say that the State searching is not as complicated as it sounds. Now under present UCC system and also under what we propose in FIPSA, you file in one State, one State, the State where the debtor is located, and that is something that has been a system in the UCC for over 35 years. It is not that difficult to determine, and in fact, under the revised article 9 that has already been passed in a few States and is moving along, it will be even clearer, it is the State of incorporation.

Mr. COBLE. Now, Mr. Brennan, since I resurrected this, do you want to revisit it?

Mr. BRENNAN. Sure.

With regard to the first issue here, right now the question is, if we have a lender who records federally and then we have a subsequent licensee who records, who prevails?

Current law is absolutely clear. The lender who recorded first prevails, ignoring the 30-, 60-day filing windows in the Copyright Act.

My question was this, under the proposal, let us assume we have a lender who only files at the State level and then we have a transferee who only records at the Federal level. Now assume that the lender forecloses. Which one prevails? I don't think that question is answered under the mixed filing proposal.

It is under current law, and that is, the licensee prevails.

With regard to the searching issues, yes, it is very easy to do a search if you know where the debtors are located. Our problem is, we don't know where these debtors are located. As I explained for Terminator 3, there are 94 separate companies in the prior chain of title, and the title reports from the Copyright Office don't tell us where they are located. The only way we can find them potentially is to search all 50 States. We may get lucky, but until we do that, we don't know where they are located.

Mr. COBLE. Mr. Attaway, this is irregular procedurally since you are not on this panel, but how do the members of the MPAA deal with the delay in processing security interest documents in the Copyright Office?

Mr. ATTAWAY. I really don't have anything to say on that subject. I believe that the delay is going to be remedied by the increase in filing fees that just went into effect that will give the Register more funds to conduct this activity, particularly enabling electronic registration. I think that will materially cut down on this problem, and I don't expect this problem to exist much longer.

Mr. COBLE. Well, folks, I appreciate this. I think this has been an illuminating and meaningful hearing. Does anybody have any closing, any last-minute thoughts before we adjourn?

I appreciate you all coming here for the hearing, and I thank you for your testimony. This concludes the oversight hearing on the report of the U.S. Copyright Office on Copyright and Digital Distance Education and the issue of Intellectual Property Security Registration. The record will remain open for 1 week.

Thank you for your cooperation and attendance, and the subcommittee stands adjourned.

[Whereupon, at 5:15 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

SCREEN ACTORS GUILD,
Hollywood, CA, June 23, 1999.

Hon. HOWARD COBLE, *Chairman,*
Subcommittee on Courts and Intellectual Property,
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR REPRESENTATIVE COBLE: On behalf of the 90,000 performers of Screen Actors Guild, Inc. ("SAG" or the "Guild"), in connection with production of motion pictures, I would like to register our interest in the unfolding debate concerning legislative revision of the legal rules governing perfection and priority of security interests in motion pictures.

The Guild often obtains security interests in motion pictures in order to enforce a variety of contractual obligations arising from employment of our performers. These security interests protect the economic interests of tens of thousands of actors and are increasingly important as methods for distribution of motion pictures—and the ability to collect residuals based on such distribution—become more complicated.

Through this experience, we recognize that the proposed "Federal Intellectual Property Security Act" ("FIPSA") and "Security Interest in Copyrights Financing Preservation Act" ("SICFPA") each contain features that would clarify existing legal rules concerning the perfection and relative priority of security interests in intellectual property. Such clarification is a favorable development for secured creditors in general, including the Guild, and may well facilitate further lending activity in this industry. As you know, this area of the law is inherently difficult, as the nature of intellectual property requires attention to rules for perfection and priority of security interests. It also demands attention to the manner in which such intangible property is defined and registered for copyright, so that chain-of-title problems do not frustrate the intent of secured parties, their debtors, and copyright owners in general. Nevertheless, the Guild finds much of merit in each proposals.

Enclosed is a memorandum discussing the legislative proposals in more detail. We hope to participate in any revision of legal rules in this area that address the aforementioned problems.

Very truly yours,
CATHERINE L. YORK, *Director of Government Relations.*

DIRECTORS GUILD OF AMERICA, INC.,
Los Angeles, CA, June 23, 1999.

Hon. HOWARD COBLE, *Chairman,*
Subcommittee on Courts and Intellectual Property,
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR REPRESENTATIVE COBLE: The Directors Guild of America, Inc. ("DGA" or the "Guild"), as the collective bargaining representative for over 10,000 directors and members of the directorial team in connection with production of motion pictures, wishes to register its interest in the unfolding debate concerning legislative revision of the legal rules governing perfection and priority of security interests in motion pictures.

The Guild often obtains security interests in motion pictures in order to enforce a variety of collective bargaining obligations arising from employment of Guild-represented employees. These security interests protect the economic interests of thousands of directors and are increasingly important as methods for distribution of motion pictures—and the ability to collect residuals based on such distribution—become more complicated.

Through this experience, the Guild recognizes that the proposed "Federal Intellectual Property Security Act" ("FIPSA") and "Security Interest in Copyrights Financing Preservation Act" ("SICFPA") each contain features that would clarify existing legal rules concerning the perfection and relative priority of security interests in intellectual property. Such clarification is a favorable development for secured creditors in general, including the Guild, and may well facilitate further lending activity in the intellectual property industries. But this area of the law is inherently difficult, as the nature of intellectual property requires attention not only to rules for perfection and priority of security interests, but also demands attention to the manner in which such intangible property is defined and registered for copyright, so that chain-of-title problems do not frustrate the intent of secured parties, their debtors, and copyright owners in general. Nevertheless, the Guild finds much of merit in each proposal.

The Guild welcomes consideration of well-crafted legislation that addresses these problems. We enclose a memorandum discussing the legislative proposals in more detail and hope to participate in any revision of legal rules in this area.

Sincerely,

WARREN ADLER, *Associate National Executive Director.*

MEMORANDUM

TO: Honorable Howard Coble
FROM: Geffiler & Bush
DATE: June 23, 1999
RE: Security Interests in Intellectual Property—Guild Issues

The Directors Guild of America, Inc. ("DGA") and the Screen Actors Guild, Inc. ("SAG") (collectively, the "Guilds"), as the respective collective bargaining representatives for over 10,000 directors and 8 0,000 actors in connection with production of motion pictures, wish to register their interest in the unfolding debate concerning legislative revision of the legal rules governing perfection and priority of security interests in motion pictures. The Guilds believe that clarification of these rules, which inherently attempt reconciliation between concepts associated with Copyright and the Uniform Commercial Code, will be useful to many intellectual property constituencies in general, and to the motion picture industry in particular, but urge careful consideration so that any changes lead to a system that functions better—rather than merely differently—for all concerned.

The proposed Federal Intellectual Property Security Act ("FIPSA") and Security Interest in Copyrights Financing Preservation Act ("SICFPA") are of great interest to the Guilds. Each Guild routinely obtains security interests in motion picture collateral from film and television producers in order to enforce a variety of collective bargaining obligations arising from employment of Guild-represented personnel in production of motion pictures. Producers bound to Guild collective bargaining agreements are often required to grant each Guild a security interest in all underlying rights and in the proceeds derived from exploitation of the motion picture in order to secure Producer's performance of collective bargaining obligations over the economic life of the film. These security interests generally parallel those obtained by banks to ensure repayment of loans to finance the picture's production, and the Guilds typically subordinate their security interests to such banks until the bank is paid in full. In normal course the bank loans are quickly repaid, and the Guilds then stand as senior secured creditors in, among other things, the picture's underlying copyright and related proceeds. Literally thousands of Guild liens are presently of record, and hundreds more are obtained each year, all of which secure performance of collective bargaining obligations to tens of thousands of actors and directors.

The Guilds find much of merit in SICFPA and FIPSA. Each proposal would enhance the ability of secured creditors to obtain the full benefit of their security interests by decreasing the risk, under *National Peregrine Inc.* v. *Capitol Fed. Savings and Loan Assoc. of Denver*, 116 B.R. 194 (C.D. 1990), that bankruptcy trustees acting as hypothetical lien creditors will take priority over a secured creditor simply because such creditor failed to record its interest with the Copyright Office. Both SICFPA and FIPSA eliminate the possibility that secured creditors will be relegated to unsecured status if they have not perfected their security interest through recordation with the Copyright Office.

Through reference to state law rules concerning priority and perfection of security interests and consequent elimination of copyright registration as a prerequisite for recordation of a security interest in a given work, each proposal would also allow secured creditors to obtain the full benefit of "after-acquired property" clauses and floating liens. These long-established concepts—which are intended to ensure that the collateral base encumbered by a security interest includes property that a debtor subsequently acquires—can be defeated in the realm of intellectual property through actions beyond control of secured parties. For example, under likely interpretation of existing case law, a security interest could be void where the debtor failed to register a work in the Copyright Office prior to granting a lien to the secured creditor. Debtors can also argue that a security interest in a screenplay does not reach the resultant motion picture, or that security interest in version "1" of computer software does not reach version "2." FIPSA and SICFPA each address these problems in a constructive manner that would enhance the availability of credit and business opportunities in intellectual property industries and also provide greater protection for Guild-represented employees.

FIPSA features further benefits to secured creditors, including clarification that security interests in intellectual property remain effective notwithstanding the sale, license or other disposition of intellectual property rights. Finally, through resort to state filing systems, each proposal will facilitate recordation of security interests within a couple of days in most state offices, a result that cannot currently be matched where Copyright Office filings must be correlated to specific works rather than the identity of debtor entities and take several months to clear.

But while FIPSA and SICFPA feature significant benefits to Guild interests, there are also some problems that could be resolved consistent with the stated objectives of the legislation. Neither proposal eliminates the need for dual filings in the Copyright Office and with applicable states. Secured creditors are well-advised to file under both tracks if they hope to ensure maximum protection in priority disputes with other creditors and if they intend to maintain security interests in the physical elements, as well as the copyright, of a motion picture or other intellectual property.

Further copyright issues presented by the current language of FIPSA include:

- Whether the Copyright Office has or will be provided the resources to develop and administer the proposed new filing system.
- The precise meaning of "ineffective" in determining priority between secured parties and transferees under FIPSA § 3(b)(2)(B)—does it relate to attachment or priority of security interests?
- Whether "ownership" under FIPSA § 3(b)(2)(B)(i) relates to ownership of rights in a Federal Intellectual Property Right, or ownership of the Federal Intellectual Property Right as a whole.
- Clarification of who must execute a federal financing statement under FIPSA § 3(b)(3)(A).
- Utilization of a "seriously misleading" standard in determining when a financing statement must be refiled due to a change in a debtor's name; this may be difficult to police and to evaluate in the event of disputes, and refiling will be a new and cumbersome burden on secured creditors.
- The need to clarify what precisely constitutes filing under § 3(b)(4)(A)(i), so as to avoid confusion over priorities derived from performance of time-sensitive formalities.
- Revision of 17 U.S.C. § 205(f) in a manner ensuring that constructive notice through Copyright Office filings will not be eliminated in connection with § 4001 of the Digital Millennium Copyright Act (28 U.S.C. § 4001), governing assumption of certain collective bargaining obligations.

Finally, the Guilds recognize that chain-of-title issues may become more complex under both Proposals where secured parties may record security interests in parallel recording schemes and may record security interests that reference intellectual property in general rather than enumerating of specific works. These issues may be of paramount importance to copyright owners and are not without significance to secured creditors who require clean chain-of-title in order to ensure the priority and perfection of their liens.

In sum, the Guilds believe the current system for recordation and perfection of copyrights in motion pictures and other intellectual property needs improvement. It remains to be seen whether either SICFPA or FIPSA are ideal vehicles for any change in this area.

PREPARED STATEMENT OF Q. TODD DICKINSON, ACTING ASSISTANT SECRETARY OF COMMERCE AND ACTING COMMISSIONER OF PATENTS AND TRADEMARKS

Mr. Chairman and Members of the Committee:

Thank you for providing us with this opportunity to present the views of the Administration on the draft bill regarding federal recordation of security interests in federal intellectual property rights.

The U.S. Patent and Trademark Office (PTO) supports efforts to provide certainty and efficiency when it comes to establishing, maintaining, recording, and transferring rights in intellectual property. However, the Administration has a number of concerns about the approach taken in the draft bill. Accordingly, we cannot support the bill as currently drafted.

The stated purpose of the draft bill is to "make substantive and procedural changes to the law in order to provide uniformity and certainty and to facilitate financing of Federal intellectual property, consistent with the rights of owners and assignees of interests in such property." Since courts have identified different requirements for perfecting notice with respect to copyrights versus patents and/or trademarks, this bill would create a federal financing statement for recording security interests in Federal intellectual property. Filing the federal financing statement would provide nationwide notice to all interested parties of the security interest in a particular intellectual property or properties.

Our comments will focus on the administrative issues raised by the draft bill. First, proposed Section 3(e) would permit the creation of three separate information databases, maintained by the Copyright Office, the PTO, and the Plant Variety Protection Office (in the Department of Agriculture), respectively. If the goal of the proposed federal finance statement is to make searching for security-interest information quick and easy, it is logical that a single database, rather than three separate databases, would fulfill this purpose. Although the current bill leaves open the possibility of a single unified database, we believe it would promote efficiency if the bill would mandate a single database and identify the agency responsible for its set-up and maintenance.

Second, and related to the issue of establishing one or more databases, we must note that even if this legislation is enacted, creating these databases will only be possible if sufficient funding is appropriated. An unfunded mandate will only burden the customers of the three Offices by diverting funds that would otherwise be spent on existing services. As currently drafted, the proposed bill is silent on the subject of funding these new costs.

Although we have identified two areas where more specificity would be helpful, as an overall matter, the Administration would prefer that the legislation be written in more general terms. Guidelines, rather than specific provisos, would ensure that the responsible agency would have the flexibility to implement the bill and to modify its practices as necessary over time. PTO's experience in running large database systems suggests that it is better not to fix details in legislation, especially where turn-around times, fees, and methods of processing data are concerned. Therefore, fees charged in connection with federal security interest filings should be set by regulation, not by statute, to permit market-type flexibility in recovering costs or passing on savings. Turn-around times, such as those marked in *Section 3(b)(4)(A)(ii)* of the proposed bill, should also be set by internal regulation, keeping in mind the importance of prompt availability.

With specific respect to the PTO, the draft bill would have the following impact. The PTO presently has an automated system for recording the chain of title relating to specific property interests, as identified by their relevant application, registration, or patent number. The draft bill would require indexing by debtor name and assignment of a number unrelated to the current application/registration numbering systems used by the Patent and Trademark operations. *(Section 3(b)(4)(A)(ii))*. Therefore, the PTO would either have to substantially modify its current automated system, or build an entirely new system. In either case, the security-interest system would have to coordinate with the current assignment system to ensure complete access to all security-interest information.

The PTO estimates that it would take at least 18 months to create and implement the required database. If paper filings as well as electronic submissions are accepted, total start-up costs and costs for one year's worth of operation would be over $7 million. We estimate that annual operating costs would average $5,000,000 per year. Fees would have to be set to recover operating costs.

The draft legislation would permit the filing of a "federal financing statement" even before a trademark, patent, or copyrightable work has been created or an application filed. This legal aspect of the proposed bill would represent a significant change in practice for the PTO, the Copyright Office, and the Department of Agriculture. With specific respect to trademarks, the proposed legislation would allow security interests to be an exception to the granting of rights in an intent-to-use (ITU) application. *(3(b)(5)*. The purpose of prohibiting assignments of ITU applications, except to a successor in interest, is to avoid trafficking in marks. Although not specifically an issue for the PTO, it is clear that debtors could file ITU applications, grant a security interest in exchange for a loan, and default on the loan. Presumably, the only collateral value would be the $245 filing fee.

The proposed legislation would also permit charging fees "in the same manner as the other fees charged by that office." *3(g)*. Since some PTO fees are set by statute and others by regulation, it is unclear which fee mechanism should apply. The PTO would prefer that the fees be set by regulation, to permit market-type flexibility in recovering costs or passing on savings. The bill is silent on whether funds would be provided to establish the database.

The bill proposes minor amendments to Section 10 of the Trademark Act and to 35 U.S.C. § 261 of the Patent Act to make clear the effect of filing a "federal financing statement."

We note that many of the legal and practical issues raised by the Federal Intellectual Property Security Act may be addressed by a study to be completed by the Franklin Pierce Law Center in cooperation with the PTO. The study, mandated under P.L. 105–277 and Senate Report 105–235 (S.2260), will assess the feasibility of establishing a centralized intellectual property registry. The study shall assess and define the technical, economic and legal requirements associated with such a centralized registry. Federal recordation of security interests in federally created intellectual property rights appears to be an important area of focus for this Congressionally mandated study. We would therefore suggest that the results of the "Franklin Pierce" study, due in early 2000, be taken into account as this draft bill moves through the legislative process.

As a final matter, we note that international discussions in the area of electronic registries for security filings, particularly at the United Nations Commission on International Trade Law (UNCITRAL), are underway. Therefore, consistency with any international developments and obligations should be taken into account as this draft bill moves through the legislative process.

We look forward to working with the Committee to craft a bill that provides service, certainty, and efficiency to security-interest recordation constituents, without jeopardizing the services available to our existing Patent and Trademark Office customers. We also note that the Department of Agriculture continues to evaluate the draft bill and may have further comments.

PREPARED STATEMENT OF JOHN C. HOLLAR, EXECUTIVE VICE PRESIDENT, LEARNING VENTURES, PUBLIC BROADCASTING SERVICE

Mr. Chairman and Members of the Subcommittee, I am John Hollar, Executive Vice President of Learning Ventures at the Public Broadcasting Service. I am pleased to have the opportunity to tell you about distance learning programs at PBS, and to share our response to the Copyright Office Report on Copyright and Digital Distance Education.

Let me first commend Register of Copyrights Marybeth Peters and her staff for the balanced report to Congress analyzing the copyright law applicable to distance education in the midst of rapid technological change. As defined by the Copyright Office, distance education is fundamentally "a form of education in which students are separated from their instructors by time and/or space."[1] The revolution in distance education that began with educational broadcasting has become the quantum leap forward of the Internet. Because we are deeply involved in the fusion of these media for educational purposes, PBS has a great interest in the Copyright Office proceeding. We thank the subcommittee for allowing PBS to participate in this hearing.

PBS DISTANCE LEARNING ACTIVITIES

At PBS, education is at the core of our mission. PBS is a nonprofit, noncommercial enterprise that makes a vast quantity of educational, cultural and informational content available in broadcast, print and electronic formats to its member television stations throughout the United States.[2] We provide programming and related services to 349 noncommercial stations in all 50 states, Puerto Rico, the U.S. Virgin Is-

[1] U.S. Copyright Office, *Report on Copyright and Digital Distance Education* (May 1999) [hereinafter *Report*] at 10.

[2] PBS was created by the Public Broadcasting Act of 1967, codified at 47 U.S.C. 390 *et seq.*

lands, Guam, and American Samoa. Nearly two-thirds of public television station licensees are universities or state and local governments. Each week, more than 97 million Americans watch and learn from PBS programming, teacher's guides, outreach efforts and web sites.

PBS is the leading television resource for classroom programming for adults and children. More teachers nationwide use programs from PBS in the classroom than from any other source.[3] More than two million teachers and 70,000 elementary and secondary schools—serving some 30 million elementary and secondary students—integrate PBS services into their curriculum. The trends are even more dramatic for post-secondary and adult learning students. As the Copyright Office noted in its Report, "telecourses" distributed by PBS have had a large audience since the 1950s and continue to expand. In 1996, more than 400,000 students were enrolled in PBS telecourses, as compared to 55,000 in 1981, according to the National Center for Education Statistics.[4]

PBS is Actively Embracing Digital Technology

Public television stations pioneered the nation's first distance learning programs, using both traditional terrestrial broadcast and instructional television fixed service (ITFS).[5] Today, to fulfill our congressional mandate of bringing PBS's educational content to all Americans, we use satellite, cable, videocassettes, and compressed digital video, and, of course, the Internet.

PBS is embracing digital technology and developing strategies for its use in meeting our educational and public service mission. While all television broadcasters are required under new FCC rules to have digital broadcasts on air no later than May 1, 2003, PBS and its stations were the first to develop all-digital networks and technical facilities, and played a leading role in developing digital broadcast transmission standards. In 1998, we launched regular broadcasts of high-definition programming and successfully broadcast the world's first digitally enhanced programming. We look forward to another breakthrough by our member stations: the digital multicasting of standard definition programming so that, for example, a single station can carry on a single digital channel its current programming *plus* a dedicated children's channel, a dedicated adult lifelong learning channel, and a dedicated local programming channel.

We are doing even more to fuse television and video programming into new, interactive online content. PBS ONLINE, one of the leading web services in the country, is pioneering the integration of broadcast television, images, audio and information into a complete multimedia learning experience for home and school. More than 6 million unique users a month spend time with PBS ONLINE, including tens of thousands of teachers, children and adult learners each day. The Internet provides the powerful "feedback loop" between our educational content and end users that has never existed before.

Recognizing the importance of these new technologies to fulfilling our mission, PBS President Ervin Duggan formed PBS Learning Ventures in 1995 to accelerate development of our lifelong learning, classroom and new media services for preschool, K–12 and adult learners. As just one example of our digital distance education activities, some 5 million Americans have enrolled in PBS ADULT LEARNING SERVICE telecourses and teleWEBcourses (which combine telecourse video and digital online instructional elements). Other programs include GOING THE DISTANCE, which provides adults the opportunity to earn full degrees using distance education; ADULT LEARNING SATELLITE SERVICE, which digitally transmits via satellite to universities, schools and libraries who download and record programs; and LITERACY LINK, which provides video and online instruction in reading, writing and arithmetic under a grant from the U.S. Department of Education. We foresee a tremendous expansion of these services in the next decade.

Public television stations work with schools and government to provide distance education throughout the nation. In rural Iowa, college degrees are accessible through the Iowa Communications Network. The Kentucky Authority for Educational Television has partnered with K–12 schools, higher education facilities and state agencies. In *College of the Air*, a partnership of Maryland Public Television and 33 colleges and universities throughout Maryland, Northern Virginia, Delaware and parts of Pennsylvania, individuals earn college credits toward a degree. Seventeen thousand students have earned college credit through telecourses offered by

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[3] *Cable in the Classroom* national survey (June 1998).

[4] National Center for Education Statistics, U.S. Department of Education, *Internet Access in Public Schools and Classrooms: 1994–1998* (Issue Brief, Feb. 1999), *cited in Report, supra* note 1, at 13, 13 n. 23.

[5] Use of ITFS is restricted by the FCC to noncommercial educational institutions.

WHYY in Philadelphia and the Delaware Valley Distance Learning Consortium, an alliance of 26 colleges and universities. The Mississippi Authority for Educational Television helps meet education needs in that rural state.[6]

PBS Comments on Copyright Law Recommendations

In the Digital Millenium Copyright Act (DMCA),[7] Congress asked the Copyright Office to recommend ways to "promote distance education through digital technologies, including interactive digital networks, while maintaining an appropriate balance" between the rights of copyright owners and users. The Register was asked to consider "the need for an exemption from exclusive rights of copyright owners for distance education through digital networks."[8]

Taking its cue from earlier legislative proposals and within a limited time frame, the Copyright Office report focuses principally on the "instructional broadcasting" exemption in section 110(2) of the 1976 Copyright Act,[9] but PBS notes that the congressional inquiry focuses more broadly on promotion of distance education through digital technologies and digital networks overall. There are a number of copyright provisions of vital importance to the educational mission of PBS and its member stations. As the Copyright Office observes, the computer is "the most versatile of distance education instruments,"[10] but provisions in the copyright law delineating educational uses for which permission is not required were written more than twenty years ago, before current digital technologies were in widespread use.[11] Provisions on transmission of noncommercial educational programming should be examined or updated in light of the new technology.

The Instructional Broadcasting Exemption in Section 110(2)

Under section 110(2) the performance of a nondramatic literary or musical work, or the display of any work, "by or in the course of a *transmission*," is exempt if it is "a regular part of the systematic instructional activities of a . . . nonprofit educational institution;" is "directly related to the teaching content of the transmission;" and is made primarily for reception in "classrooms or similar places normally devoted to instruction," or by persons whose disabilities or special circumstances prevent their attendance in classrooms or similar places, or by government officers or employees as part of their official duties.[12]

The instructional broadcasting exemption in section 110(2) was designed in part for "educational television or radio" entities[13] that transmit, with a participating nonprofit educational institution or governmental body, certain distance learning content for reception in a classroom, "a studio, a workshop, a gymnasium, a training field, a library . . . or the auditorium" when used for systematic instruction[14]; or for reception by persons whose "special circumstances" keep them out of a classroom, such as "preschool children, displaced workers, illiterates, and shut-ins."[15] Section 110(2) "is intended to include instructional television college credit courses" such as "telecourses" aimed at "regularly enrolled" students "who are unable to attend daytime classes because of daytime employment, distance from campus, or some other intervening reason."[16]

The exemption thus permits instructional broadcasters a range of distance education activities with respect to displays of works, and performances of literary and musical works. At the same time, PBS holds broad audiovisual rights in most of our distributed programming, and we represent the interests of our program producers and producing member stations in providing programming to the K–12 and adult education communities. Maintaining the proper copyright balance is, therefore, of

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[6] Further examples of public television distance learning services are provided with our written comments to the Copyright Office. *See* Comments of the Corporation for Public Broadcasting, Association of America's Public Television Stations, and Public Broadcasting Service, *In the Matter of Promotion of Distance Education Through Digital Technologies* (Exhibit 1).

[7] Pub. L. No. 105–304, 112 Stat. 2860 (1998).

[8] *Id.* § 403. In response to Copyright Office inquiries, 63 Fed. Reg. 63,749 (1998); 63 Fed. Reg. 71,167 (1998), PBS jointly submitted comments and reply comments with the Corporation for Public Broadcasting (CPB) and Association of America's Public Television Stations (APTS).

[9] *Report, supra* note 1, at 143.

[10] *Id.* at 53.

[11] *Id.* at 1–2.

[12] 17 U.S.C. § 110(2) (1976) (emphasis added).

[13] *See* H.R. Rep. No. 94–1476 at 83 (1976). *See also* Melville B. Nimmer and David Nimmer, Nimmer on Copyright § 8.15[C][1], [C][4] (section 110(2) exemption covers transmission by a noncommercial educational broadcasting station or other transmitting entity with a nonprofit educational institution or government body).

[14] H.R. Rep. No. 94–1476 at 82–83 (1976) (reference to "classrooms or similar places" has same meaning as in section 110(1)).

[15] *Id.* at 84.

[16] *Id.*

concern to PBS. The important task, in our view, is to begin to examine specific copyright law provisions and exemptions as they affect distance education in the digital environment.

Digital Transmission under Section 110

The Register of Copyrights recommends updating the instructional broadcasting exemption in section 110(2) to clarify that the same performances and displays the provision has always permitted may also be delivered by means of digital technologies. To accomplish this, the Copyright Office has three recommendations. First, the Register recommends clarifying that a "transmission" may be digital. Notably, the Copyright Office urges that the term "transmission" in section 110(2) should be clarified through legislative history rather than statutory amendment: "Because the term does not specify any particular technology, we interpret it to cover transmission in any form, including digital. Amending the statute to add the words 'digital or analog' is therefore unnecessary, and *risks implying that references to 'transmission' elsewhere in the Copyright Act are limited to analog transmissions*."[17] The Office notes that the definition of "transmission" in section 101 of the Act is technologically neutral, covering communication "by any device or process whereby images or sounds are received beyond the place from which they are sent" and should therefore include digital transmissions.[18]

Second, the Register recommends permitting the transient copies that are necessarily created by intermediate RAM storage as a work is performed or displayed by digital transmission. As described in the Report, transient copies are created in a computer's random access memory as digital information is transported over a digital network, so that even where there is an applicable exemption from the performance or display right, a transmission online may implicate the reproduction right as well.[19] According to the Copyright Office, these temporary copies occur along the network even with video or audio "streaming" (i.e., real time transmission) even though no complete copy is reassembled on the recipient's computer.[20] The Office would permit these temporary copies as part of legitimate distance education under 110(2).

Third, to permit the section 110(2) exemption to be used in asynchronous distance education, the Office would add a new ephemeral recording exemption in section 112 of the Copyright Act to permit an educator or other entity to upload a copyrighted work onto a network server for subsequent transmission to students under the conditions set out in 110(2).[21]

PBS supports the Register's recommendation to confirm through legislative history the applicability of the copyright law exemptions to digital transmissions. One goal of the copyright law revision in the 1970s was to craft a statute flexible enough to accommodate new technologies.[22]

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[17] *Report, supra* note 1, at 146 (emphasis added). *See also* Melville B. Nimmer and David Nimmer, Nimmer on Copyright § 8–15[C][1] (transmission in 110(2) includes not only radio and television broadcasts over-the-air but communication by any device or process).

[18] *Id.* at 83.

[19] *Id.* at 70–71 (citing *MAI Sys. Corp.* v. *Peak Computer, Inc.*, 991 F.2d 511 (9th Cir. 1993), *cert. dismissed*, 114 S.Ct. 671 (1994)).

[20] *Id.* at 71 n. 159.

[21] Section 112(b) already permits a nonprofit organization, such as an instructional broadcaster, entitled to perform or display a work under section 110(2) to make up to 30 copies of a particular transmission program embodying the performance or display under 110(2). According to the legislative history, an organization that has made copies under 112(b) may use one of them for purposes of its own exempt transmissions under section 110(2), and may do so repeatedly in any number of transmissions for seven years from the date the program was first transmitted to the public. H.R. Rep. No. 94–1476 at 103–04 (1976). The Office believes this provision might not permit the indefinite number of transient RAM copies generated by digital transmission from the server copy. *Report, supra* note 1, at 94.

The Office observes that allowing a network server copy for asynchronous access could displace sales. *Id.* at 148. *See also* H.R. Rep. No. 94–1476 at 103–04 (1976) (discussing effect of ephemeral recording exemption on educational video market). To address this, the Office would require the server copy to be made from a lawfully acquired copy, with all technological protections intact; allow the server copy only for duration of the course, with no further copies made from it "except for the transient technologically necessary copies that would be permitted by section 110(2)"; and replace the requirement of "systematic instructional activities" with a "mediated instruction" requirement such that the performance or display is made at the direction of an instructor, *Report, supra* note 1, at 148, 161, which PBS believes could narrow the exemption. *See* H.R. Rep. No. 94–1476 at 83 (transmission need not be related to specific course work if in accordance with pattern of systematic teaching methods established by the nonprofit educational institution or government body).

[22] *See* H.R. Rep. No. 94–1476 at 51 (1976).

Digital Transmission under Section 118

In this context, we would bring to your attention the statutory license in section 118 for certain uses by public broadcasting entities of published nondramatic musical works, or pictorial graphic and sculptural works, in the course of a *transmission* made by a noncommercial educational broadcast station, subject to the terms of any voluntary, industry-wide license agreement. The legislative history reflects that public broadcasting should be assured "access to copyrighted materials at reasonable royalties and without administratively cumbersome and costly 'clearance' problems that would impair the vitality of their operations" and that public broadcasting "may encounter problems not confronted by commercial broadcasting enterprises, due to such factors as the special nature of programming, repeated use of programs, and, of course, limited financial resources."[23] The idea was not to "subsidize public broadcasters," but to "assure a fair return to copyright owners without unfairly burdening public broadcasters."[24]

Music performing and mechanical rights societies have asserted that programs incorporating musical works under section 118 licenses may not be transmitted in new media without further license. Public broadcasters have faced the challenges in obtaining licenses for digital uses that some reported to the Office during the study of digital distance education.[25] Licensing issues have become ever more complex as technology has evolved and programs must be cleared for different distribution methods. While satellite digital broadcasts may be adequately addressed in other provisions of the Copyright Act, it would be helpful and in the public interest for Congress to clarify that licenses for "transmission" by public broadcasters under section 118 may include other digital transmissions.[26] As the Copyright Office states in its report, "Where a statutory provision that was intended to implement a particular policy is written in such a way that it becomes obsolete due to changes in technology, the provision may require updating if that policy is to continue. Doing so may be seen not as preempting a new market, but as accommodating existing markets that are being tapped by new methods."[27]

Digital Transmissions under Section 114

PBS was also pleased that the Copyright Office took note of public broadcasting's exemption with respect to sound recordings in section 114(b), under which the reproduction, distribution and derivative work rights in section 106(1)–(3) do not apply to sound recordings included in "educational television and radio programs" distributed *or transmitted by* or through "public broadcasting entities," so long as copies or phonorecords of the programs are not commercially distributed by or through public broadcasting entities to the general public.[28] The Office observed that there is no exemption in 114(b) from section 106(6), such that in "the digital world" the performance right "would still apply."[29] While the Office is correct that the public broadcasting exemption for sound recordings in 114(b) does not specifically mention the digital performance right in 106(6), when Congress added the digital performance right for sound recordings in 1995 it expressly excluded the transmission of an audiovisual work from the definition of "digital audio transmission."[30] In so doing, it intended "to make clear that the performance right . . . applies only to digital transmissions of sound recordings and that nothing in the bill creates any new copyright liability with respect to the transmission of a motion picture or other audiovisual work, whether digital or analog, whether subscription or nonsubscription, and whether interactive or noninteractive."[31] In its essential function of delivering noncommercial educational and cultural audiovisual programming, therefore,

[23] *Id.* at 117–18.

[24] *Id.*

[25] *See Report, supra* note 1, at 41–44.

[26] The Report distinguishes between "digital transmissions" (reproduction over networks that automatically create intermediate copies) and "digital broadcasts" (which may be communicated by satellite, microwave or cable and which do not involve automatic creation of intermediate copies and are therefore from a copyright perspective more similar to analog broadcasts than to online transmission). *Id.* at 84. This distinction may become tenuous as digital technologies evolve and converge. Section 118(d)(2)–(3) permits reproductions "for the purpose of transmissions" including "'interconnection' activities serving as a technical adjunct to such transmissions, such as the use of satellites or microwave equipment." H.R. Rep. No. 94–1476 at 119 (1976).

[27] *Report, supra,* note 1, at 144–45.

[28] *See id.* at 97 (citing 17 U.S.C. § 114(b)).

[29] *Id.* at 98.

[30] *See* 17 U.S.C. § 114(j) (definition of "digital audio transmission").

[31] S. Rep. No. 104–128 at 33 (1995). *See also id. at* 16 ("digital transmission of audiovisual works not covered by act"). *Accord*, H.R. Rep. No. 104–274 at 25 (1995).

public television is exempt from the digital performance right in sound recordings.[32] To the extent that the reproduction right may be implicated through Internet transmission by intermediate RAM storage, that problem does not exist for sound recordings incorporated into programs "transmitted by or through public broadcasting entities" because under 114(b) the reproduction, distribution and derivative work rights do not apply.[33]

MAINTAINING THE PROPER BALANCE

Notwithstanding the continuing vital importance of these exemptions to the educational mission of public broadcasting as it enters the digital era, PBS is not entirely on the "user" side of the copyright equation. PBS favors most of the technological safeguards called for by the Copyright Office to protect copyrighted works used in distance education from new risks posed by new technology. The report cites a number of protections: passwords, encryption, firewalls, digital watermarking, digital containers (such as Adobe Acrobat), physical objects (such as laser discs or DVDs) provided only to authorized users, and videostreaming formats that never create a whole copy on a user's computer, thereby inhibiting downstream uses.[34] PBS's major producers and stations already employ many of these safeguards to prevent unauthorized uses. Some use encryption or digital fingerprinting for satellite delivered telecourses. Password protection is not uncommon on Internet sites. Provision of physical videocassettes or DVDs is standard practice, and secure videostreaming is imminent. As technology improves, the security of digital distance education programs will improve. PBS is participating in the *Instructional Management System* project, a cooperative effort among corporate, non-profit, and government organizations (including the National Institute of Standards and Technology and U.S. Department of Defense) to develop open technological standards for instructional systems and content for the digital learning environment. These standards will help educators and students find educational materials on digital networks and identify the source, facilitating copyright protections and permissions for material made available in the digital environment. PBS also provides information on copyright law for its member stations and for educational institutional users of PBS programming.

Digital Fair Uses

PBS recognizes that technologies that place copyrighted works under lock and key may also inhibit legitimate "fair uses" in the digital environment. We agree with the Copyright Office that a clarification that fair use applies in the digital environment would be welcome and helpful to teachers and students.[35] PBS was a participant in the Conference on Fair Use (CONFU) discussions on digital fair use guidelines. While we have not endorsed the proposed Educational Multimedia or Distance Learning Guidelines, we are generally supportive of the concept and believe they may provide some guidance for application of fair use principles by educators, scholars and students who develop educational multimedia projects using portions of copyright works, or who engage in distance learning activities. We endorse the fair use off-air taping guidelines that allow nonprofit educational institutions to record, use and store certain television broadcasts for limited periods and under certain conditions. PBS generally secures from producers, and grants to educational institutions, taping rights that exceed the fair use guidelines to permit retention and use by an educational institution for a full year.

The Report suggests that availability of the 110(2) exemption be conditioned on use of measures to control unauthorized access and uses, and an obligation not to

[32] Congress may wish to consider placing a limitation from 106(6) in 114(b) to assist all public broadcasting to fully pursue its activities through Internet transmission. Alternatively, Congress could include a statutory license in section 114 for "digital audio transmissions" by public broadcasters (whose primary purpose is transmitting noncommercial educational and cultural programming), or add sound recordings to the categories of works in section 118. Otherwise, the problem of negotiating licenses for sound recordings will be difficult for public broadcasters, because in contrast to licenses for musical works under section 118, section 114(e)(2) limits negotiations by common entities for rates and terms. As the Copyright Office notes with respect to section 110, there was no performance right in sound recordings when exemptions and licenses for nonprofit educational broadcasting in sections 114(b) and 118(d) were enacted. *See Report, supra* note 1, at 79, 156–57.

[33] Also exempt under section 114(d) are nonsubscription radio or television broadcast transmissions by FCC-licensed terrestrial broadcast stations; simultaneous retransmissions of such television broadcasts; and some retransmissions of such radio broadcasts, including nonsubscription terrestrial broadcast retransmissions of noncommercial educational and cultural radio programs, whether or not simultaneous.

[34] *Report, supra* note 1, at 50, 59–60, 65–66.

[35] *See id.* at 162.

interfere with standard technological protections applied to a work.[36] Technological safeguards are important. However, the Digital Millenium Copyright Act already contains significant requirements in this regard.[37] As standard technological protections come into place, PBS does not oppose the Copyright Office suggestion that Congress consider expanding the category of works covered by section 110(2) to include *portions of* audiovisual works and sound recordings,[38] to the extent that a noncommercial educational broadcasting entity could transmit a PBS VIDEO clip, or a small portion of a sound recording from PBS RECORDS, where the performance or display of the work is "directly related and of material assistance to the teaching content of the transmission." Even in our capacity as rights holder, we believe this use would under certain circumstances be consistent with the purposes of section 110(2) and the proposed fair use guidelines for distance education and educational multimedia, so long as portions permitted are reasonable; developing specific guidelines as to fair uses under section 107 is another approach.

Common educational objectives

As the Copyright Office states, the distance learning "goal is to permit instruction to take place anywhere."[39] PBS shares this goal. The Report recommends replacing as outdated the requirement in section 110(2) of a physical classroom with a requirement of "official enrollment" and limiting transmissions "solely, to the extent technologically feasible" to students enrolled in the particular course for which the transmission is made.[40] Section 110(2) currently permits transmissions to a classroom or similar place normally devoted to instruction, *and* to persons whose special circumstances prevent their attendance in classrooms, such as preschoolers, displaced workers, illiterates, shut-ins, and "regularly enrolled students" with "daytime employment, distance from campus, or some other intervening reason."[41] The transmission must be made "primarily" for reception by such groups, or by government personnel, and need not be related to specific course work if part of the institution's systematic teaching methods.[42] Thus, section 110(2) may already accomplish the distance learning goal, while permitting a nonprofit educational institution or, governmental body to engage in "transmissions providing systematic instruction to . . . preschool children, displaced workers, illiterates and shut-ins" who may have limited physical or technological access to educational resources.[43] Finally, we appreciate the Register's recommendation to maintain, subject to further study, the existing eligibility requirements for the section 110(2) exemption, which is available to "nonprofit educational institutions" and government bodies.[44] The Copyright Act, even in newer provisions added by the DMCA, contains several references to "nonprofit educational institutions" and their special function in our society. PBS carefully maintains its nonprofit status as it makes educational programming available nationwide. Even in the digital age, the concept of nonprofit, educational uses of copyrighted works, rather than commercial uses of those works, continues to have currency and legitimacy.

Mr. Chairman, I thank you for the opportunity to share the views of PBS.

[The information referred to follows:]

[36] *Id.* at 150–52.

[37] *See* 17 U.S.C. § 1201(a)(1) (prohibiting circumvention of technological measures that control access to a copyrighted work); *id.* § 1202 (b) (prohibiting intentional removal or alteration of copyright management information, or public performance of works knowing that copyright management information is removed or altered, without authority of copyright owner or law).

[38] *See Report, supra* note 1, at 155.

[39] *Id.* at 149.

[40] *Id.* at 149–50.

[41] H.R. Rep. No. 94–1476 at 83–84.

[42] *Id.* at 83.

[43] *See id.* at 84.

[44] *Report, supra* note 1, at 153–54.

Report on Copyright and Digital Distance Education

Executive Summary

U.S. Copyright Office

May 1999

A Report of the Register of Copyrights

INTRODUCTION

Over the past five years, the application of copyright law to distance education using digital technologies has become the subject of public debate and attention in the United States. In the Digital Millennium Copyright Act of 1998 (DMCA), Congress charged the Copyright Office with responsibility to study the issue and report back with recommendations within six months. After an intensive process of identifying stakeholders, holding public hearings, soliciting comments, conducting research, and consulting with experts in various fields, the Office has issued this Report.

Part I of the Report gives an overview of the nature of distance education today. Part II describes current licensing practices in digital distance education, including problems and future trends. Part III describes the status of technologies relating to the delivery and protection of distance education materials. Part IV analyzes the application of current copyright law to digital distance education activities. Part V discusses prior initiatives addressing copyright and digital distance education. Part VI examines the question of whether the law should be changed, first summarizing the views of interested parties and then providing the Copyright Office's analysis and recommendations.

I. THE NATURE OF DISTANCE EDUCATION TODAY

Distance education in the United States today is a vibrant and burgeoning field. Although it is far from new, digital technologies have fostered a rapid expansion in recent years, as well as a change in profile. The technologies used in distance education, the populations served, the institutions offering such programs, and the partnerships that have emerged differ in nature and scale from earlier models.

The most fundamental definition of distance education is a form of education in which students are separated from their instructors by time and/or space. Distance education is utilized in some form at every level of the educational spectrum, with the most extensive use in higher education. An individual course may contain both classroom and distance education components. Digital technology is used extensively for varied purposes and in varied ways, depending on the intended audience for the course, and the availability and cost of the technology. The capabilities of the new technologies have made possible a more interactive experience that more closely parallels face-to-face teaching--in effect creating a virtual classroom. They have also made distance education courses more convenient and better suited to the needs of different students, including by providing the benefits of both synchronous and asynchronous methods.

Distance education is reaching wider audiences, covering all segments of the population. The college audience is increasing particularly rapidly, in part due to responsiveness to the needs of an older, non-traditional student population, as well as students in other countries. Students also include professionals engaging in professional development or training, and retirees. The expansion of the field has led to changes among providers, with courses offered by both nonprofit and for-profit entities, on both a nonprofit and for-profit basis, and through varieties of partnerships among educational institutions and corporations. The federal government has been active in promoting the benefits of distance education, with recent legislation providing funding and recognition in various forms.

Educational institutions offering distance education draw on library resources in several ways, including to provide support for online courses and to provide access to supplemental materials in digital form. Institutions are engaged in adopting copyright policies, training faculty and staff, and educating students about copyright law. They are increasingly seeking and obtaining formal accreditation.

II. LICENSING OF COPYRIGHTED WORKS

Although substantial licensing activities are taking place today in connection with the provision of materials to distance education students, so far relatively few licenses are requested or granted for digital uses. Most licensing relates to supplemental materials in analog form, or, increasingly, in digital form; the least common type of licensing is for digital uses of copyrighted works incorporated into the class itself. Most of the works licensed for digital use are textual materials; licenses for other types of content are much less frequent. As an alternative to seeking a license, an educational institution may avoid the use of preexisting copyrighted works in distance education courses, or may rely on exemptions in the copyright law. There is wide diversity in licensing procedures among educational institutions and copyright owners. In general, the more resources devoted to licensing, and the more centralized the responsibility, the more efficient and successful the process.

Many educational institutions describe having experienced recurrent problems with licensing for digital distance education, primarily involving difficulty locating the copyright owner, inability to obtain a timely response, or unreasonable prices or other terms. The problems are reported to be most serious with respect to journal articles and audiovisual works. They appear to be exacerbated in the digital context, which may be explained in part by the perception of copyright owners that the risks of unauthorized dissemination are greater, and in part by the elements of novelty and unfamiliarity.

A number of trends may facilitate the development of more effective digital licensing in the near future, including advances in technology used to protect works, the use of electronic copyright management information, and online licensing systems. New collective initiatives should also ease the licensing process for many types of uses. As digital uses become more common and familiar, copyright owners are becoming more flexible. It is difficult to predict the extent to which licensing problems will subside or how long the improvement will take, but given the current state of development of these trends, a more definitive evaluation will be possible in the next few years.

III. TECHNOLOGIES INVOLVED IN DIGITAL DISTANCE EDUCATION

Technology that facilitates licensing includes the ability to attach information to a work in digital format, and online rights and permissions services supporting a range of license and delivery functions. A number of different delivery technologies are used in distance education today, including traditional media used to carry digital information, such as digital television broadcasts or videoconferencing. These may be used in combination with digital network technology, such as computer connections between students and instructors.

The computer is the most versatile of distance education instruments, since it can perform the same function as a television or telephone, but also provide more interactivity, deliver more content, and support more comprehensive services. Computers can be used to tools for both exist today; it will be clearer within the next few years how successfully they can be integrated into the real world of distance education. Given the timetable of the legislative process, the question is what steps Congress can and should take in the interim.

Over the course of this study, numerous issues have been raised and discussed. Given the limited time allotted, the specific mandate for the Register to consider primarily "the need for an exemption from exclusive rights of copyright owners for distance education through digital networks," and the origin of that mandate in proposed amendments to section 110(2), our analysis focuses on the appropriate treatment under copyright law of materials delivered to students through digital technology in the course of mediated instruction. We do not address other uses of copyrighted works in the course of digital distance education, including student use of supplemental or research materials in digital form; the creation of multimedia works by teachers or students; and the downloading and retention of materials by students. Such activities, although an important part of digital distance education, do not involve uses analogous to the performances and displays addressed in section 110(2).

As a fundamental premise, the Copyright Office believes that emerging markets should be permitted to develop with minimal government regulation. When changes in technology lead to the development of new markets for copyrighted works, copyright owners and users should have the opportunity to establish mutually satisfactory relationships. A certain degree of growing pains may have to be tolerated in order to give market mechanisms the chance to evolve in an acceptable direction. At some point, however, existing but dysfunctional markets may require adjustments in the law. Timing is therefore key.

The desire to let markets evolve does not mean that the law must remain frozen.

Where a statutory provision intended to implement a particular policy is written in such a way that it becomes obsolete due to changes in technology, the provision may require updating if that policy is to continue. Doing so may be seen not as preempting a new market, but as accommodating existing markets that are being tapped by new methods. In the view of the Copyright Office, section 110(2) represents an example of this phenomenon.

The exemptions in sections 110(1) and (2) embody a policy determination that performances or displays of copyrighted works in the course of systematic instruction should be permitted without the need to obtain a license or rely on fair use. The technological characteristics of digital transmissions have rendered the language of section 110(2) inapplicable to the most advanced delivery method for systematic instruction. Without an amendment to accommodate these new technologies, the policy behind the law will be increasingly diminished.

At the same time, it must be borne in mind that existing law was crafted to embody a balance of interests between copyright owners and users of works. In order to maintain a comparable balance, the coverage of an exemption cannot be expanded without considering the impact of the expansion on markets for copyrighted works. If the law is updated to address new technology, the risks posed by that technology must be adequately taken into account.

Updating section 110(2) to allow the same activities to take place using digital delivery mechanisms, while controlling the risks involved, would continue the basic policy balance struck in 1976. In our view, such action is advisable.

Other amendments have been suggested that would go further, and entail varying degrees of change in legislative policy. These include expanding the exemption to cover more categories of works or additional exclusive rights beyond those necessary for digital delivery, and otherwise resolving problems experienced in the licensing process. Here, the elements of timing and burden of proof are critical. From a pedagogical perspective, these suggested expansions are desirable. From a copyright owner's perspective, they endanger primary or secondary markets for valuable works. The question should not be whether users have established a need to expand the exemption, any more than whether copyright owners have established a need to retain its limits, but rather whether given current conditions, the policy balance struck in 1976 should be recalibrated in certain respects.

We conclude that some policy recalibration may be appropriate at this point, relating primarily to categories of works covered. In other areas, we believe that existing restrictions should be retained and markets permitted to evolve, subject to further review. Critical to this conclusion is the continued availability of the fair use doctrine as a safety valve.

1. Recommendations as to Statutory Language.

In order to accomplish the goal of updating the language and the policy balance of section 110(2), the Copyright Office offers the following recommendations:

(a) Clarify meaning of "transmission." It should be clarified through legislative history that the term "transmission" in section 110(2) covers transmissions by digital means as well as analog.

(b) Expand coverage of rights to extent technologically necessary. Because the exemption in its current form permits only acts of performance and display, digital transmissions over computer networks would not be excused. We therefore recommend expanding the scope of the rights covered, in order to add those needed to accomplish this type

of transmission. The rights of reproduction and/or distribution should not be added in their entirety, but only to the extent technologically required in order to transmit the performance or display authorized by the exemption.

(c) Emphasize concept of mediated instruction. An exemption that includes elements of the reproduction right so as to allow a student to access individual works asynchronously raises an unintended problem. If an entire work can be viewed on a computer screen, repeatedly, whenever a student chooses and for an indefinite duration, the performance or display could conceivably function as a substitute for the purchase of a copy. In updating section 110(2), it is therefore critical to ensure that the performance or display is analogous to the type of performance or display that would take place in a live classroom setting. This might be accomplished by amending paragraph (A) of section 110(2), which requires the performance or display to be "a regular part of . . . systematic instructional activities," to focus on the concept of mediated instruction. Additional language could specify that the performance or display must be made by or at the direction of an instructor to illustrate a point in, or as an integral part of, the equivalent of a class session in a particular course.

(d) Eliminate requirement of physical classroom. In its current form, section 110(2) requires transmissions to be sent to a classroom or similar place normally devoted to instruction, or to persons who cannot attend a classroom. The nature of digital distance education, where the goal is to permit instruction to take place anywhere, makes this limitation conceptually and practically obsolete. Eliminating the physical classroom limitation would better reflect today's realities.

At the same time, it is important to retain meaningful limitations on the eligible recipients; the performances or displays should not be made available to the general public. We recommend permitting transmissions to be made to students officially enrolled in the course, regardless of their physical location. Since today's digital and scrambling technologies allow transmissions to be targeted more precisely, the requirement should be added that the transmission must be made solely, to the extent technologically feasible, for reception by the defined class of eligible recipients.

(e) Add new safeguards to counteract new risks. Because the transmission of works to students in digital form poses greater risks of uncontrolled copying and distribution, a broadened exemption could cause harm to markets beyond the primary educational market. It is therefore critical, if section 110(2) is expanded to cover digital transmissions, that safeguards be incorporated into the statute to minimize these risks. We recommend including a number of safeguards as conditions on the applicability of the exemption: First, any transient copies permitted under the exemption should be retained for no longer than reasonably necessary to complete the transmission. Second, those seeking to invoke the exemption should be required to institute policies regarding copyright; to provide informational materials to faculty, students, and relevant staff members that accurately describe and promote compliance with copyright law; and to provide notice to students that materials may be subject to copyright protection.

Third, when works are transmitted in digital form, technological measures should be in place to control unauthorized uses. In order to effectively limit the risks to copyright owners' markets, these measures should protect against both unauthorized access and unauthorized dissemination after access has been obtained. The exemption should require the transmitting institution to apply such measures, described in simple and technology-neutral language. Because no technology is one hundred percent effective, only measures that "reasonably" prevent these acts should be required. In addition, the law should impose an obligation not to intentionally interfere with protections applied by the copyright owners themselves. If copyrighted works are to be placed on networks, and exposed to the resulting risks, it is appropriate to condition the availability of the exemption on the application of adequate technological protections.

(f) Maintain existing standards of eligibility. An educational institution must be "nonprofit" to be eligible for the exemption in section 110(2). There was extensive debate over the appropriateness of retaining the "nonprofit" requirement, and/or adding a requirement of accreditation. In the area of digital distance education, the lines between for-profit and nonprofit have blurred, and the issue has arisen as to how to guarantee the bona fides of an entity that is entitled to the exemption at a time when anyone can transmit educational material over the Internet. The Copyright Office is not convinced at this point that a change in the law is desirable, given the policy implications of permitting commercial entities to profit from activities using copyrighted works without compensating the owners of those works; the potential inconsistency with other provisions of the Act, including section 110(1), that refer to "nonprofit educational institutions"; and the DMCA mandate to consult specifically with nonprofit educational institutions and nonprofit libraries and archives. This is nevertheless an important and evolving issue that deserves further attention.

(g) Expand categories of works covered. One of the most difficult issues to resolve is whether to expand the categories of works exempted from the performance right

beyond the current coverage of nondramatic literary and musical works. On the one hand, pedagogical considerations militate against continuing to limit the types of works covered. On the other hand, the existing distinctions have been embedded in the law for more than twenty years, based on the potentially greater market harm to works such as dramatic works or audiovisual works. The question is why this policy judgment should be altered now.

The main categories of works that could be affected by an expansion are audiovisual works, sound recordings, and dramatic literary and musical works. In terms of primary markets, educational licensing may represent a major source of revenue only for educational videos. The potential effect on secondary markets, however, remains a serious concern for all such works. This concern has been exacerbated beyond the threats perceived in 1976 by the capacities of digital technology. For entertainment products like motion pictures, transmission could well substitute for students paying to view them elsewhere, and if digital copies can be made or disseminated, could affect the broader public market.

The considerations are different for sound recordings than for other categories. Because there was no public performance right for sound recordings when section 110(2) was enacted in 1976, educators were free to transmit performances of sound recordings to students (assuming the use of any other work embodied in the sound recording was authorized by statute or license). When owners of sound recordings were granted a limited public performance right in 1996, there was no discussion of whether sound recordings should be added to the coverage of section 110(2). This issue thus represents a new policy question that has not yet been considered, rather than a potential change in a judgment already made.

It is the exclusion of audiovisual works, however, about which educators express the strongest concern, in part due to difficulties in obtaining licenses for digital uses from motion picture producers. Moreover, as digital distance education uses more multimedia works, which incorporate audiovisual works and may be considered audiovisual works themselves, the failure to cover this category may have an increasing impact.

On balance we suggest a compromise. If audiovisual and other works are added, it should be done in a limited way, with greater restrictions than section 110(2) currently imposes. Thus, section 110(2) could be amended to allow performances of categories in addition to nondramatic literary and musical works, but not of entire works. An expanded exemption should cover only the performance of reasonable and limited portions of these additional works.

It is important to note that under the current language of section 110(2), the portion performed would have to be the subject of study in the course, rather than mere entertainment for the students, or unrelated background or transitional material. This requirement, combined with the limitation on the amount of the work that could be used, should further serve to limit any impact on primary or secondary markets. It nevertheless may be advisable to exclude those works that are produced primarily for instructional use. For such works, unlike entertainment products or materials of a general educational nature, the exemption could significantly cut into primary markets, impairing incentives to create.

(h) Require use of lawful copies. If the categories of works covered by section 110(2) are expanded, we recommend an additional safeguard: requiring the performance or display to be made from a lawful copy. Such a requirement is already contained in section 110(1) for the performance or display of an audiovisual work in the classroom.

(i) Add new ephemeral recording exemption. Finally, in order to allow the digital distance education that would be permitted under section 110(2) to take place asynchronously, we recommend adding a new subsection to section 112, the ephemeral

recordings exemption. The new subsection would permit an educator to upload a copyrighted work onto a server, to be subsequently transmitted under the conditions set out in section 110(2) to students enrolled in her course. The benefit of the new subsection should be limited to an entity entitled to transmit a performance or display of a work in digital form under section 110(2). Various limits should be imposed similar to those set out in other subsections of section 112, including the requirements that any such copy be retained and used solely by the entity that made it; that no further copies be reproduced from it (except the transient technologically necessary copies that would be permitted by section 110(2)); that the copy be used solely for transmissions authorized under section 110(2); and that retention of the copy be limited in time, remaining on the server in a form accessible to students only for the duration of the course. In addition, the reproduction should have to be made from a lawful copy. Finally, the entity making the reproduction should not be permitted to remove technological protections applied by the copyright owner to prevent subsequent unlawful copying.

2. Clarification of Fair Use.

Because there is confusion and misunderstanding about the fair use doctrine, including the function of guidelines, we believe it is important for Congress to provide some clarification. The statutory language of section 107 is technology-neutral, and does not require amendment. But if any legislative action is taken with regard to distance education, we recommend that report language explicitly address certain fair use principles.

First, the legislative history should confirm that the fair use doctrine is technology-neutral and applies to activities in the digital environment. It might be useful to provide some examples of digital uses that are likely to qualify as fair. It should be explained that the lack of established guidelines for any particular type of use does not mean that fair use is inapplicable.

Finally, the relationship of guidelines to fair use and other statutory defenses should be clarified. The public should understand that guidelines are intended as a safe harbor, rather than a ceiling on what is permitted.

Although flexibility is a major benefit of the fair use doctrine, the corollary is a degree of uncertainty. This drawback is exacerbated by the context of new technologies, where little case law is available. In the analog world, efforts such as the photocopying and off-air taping guidelines have proved helpful in giving practical guidance for day-to-day decisionmaking by educators. The Copyright Office believes that additional discussion among the interested parties of fair use as applied to digital distance education could be productive in achieving a greater degree of consensus. In the past, efforts to develop guidelines have been successful where a consistent group of participants worked within a structure established under the auspices of a government agency, with some direction provided by Congress.

3. Licensing Issues.

The fact that digital technologies impose new costs on delivering distance education does not itself justify abandoning or regulating the long-standing licensing system. Digital distance education entails the use of computer hardware and software, and the employment of trained support staff, all of which cost money. Digital distance education may also entail the use of preexisting copyrighted works. This content is at least as valuable as the infrastructure to deliver it, and represents another cost to be calculated in the equation.

The critical question here is whether the markets in which distance educators participate are dysfunctional, and if so, to a degree that calls for a legislative remedy. While the problems experienced in licensing are not unique to digital distance education, they are heightened in the digital context due to factors such as fear about increased risks; lack of certainty as to the scope of pre-digital transfers of rights; and general unfamiliarity with new uses. Many of these factors should diminish with time and experience, and there are some indications that this is already happening. In addition, online and collective licensing for digital uses will increasingly facilitate transactions. Nevertheless, problems will persist for the foreseeable future, as long as risks are perceived as high or benefits low.

One of the problems identified by educators has special characteristics that can block the functioning of the marketplace. Where the owner of the work simply cannot be located, there is no opportunity to negotiate. Particularly because the problem of such "orphan works" may become more acute due to longer copyright terms and the expanded audience for older works made possible by digital technology, we believe that the time may be ripe for Congressional attention to this issue generally.

We have not otherwise seen sufficient evidence of a need for a legislative solution moving away from the general free market approach of current law. Given the state of flux of online licensing systems and technological measures, and the waning influence of the elements of fear and unfamiliarity, problems of delay and cost may subside to an acceptable level. At this point in time we recommend giving the market for licensing of nonexempted uses leeway to evolve and mature. Because the field of digital distance education is growing so quickly, and effective licensing and technologies may be on the horizon, we suggest revisiting the issue in a relatively short period of time.

4. International Considerations.

In making these recommendations, the Copyright Office is mindful of the constraints of U.S. treaty obligations. In our view, the relevant criteria of the Berne Convention and the TRIPs Agreement are fundamentally in harmony with domestic policy considerations. We believe that our recommendations are fully consistent with these criteria, and would not alter the fundamental balance of either section 110(2) or 112, which have been part of U.S. law for more than twenty years.

The balance struck in U.S. law will have an importance beyond our borders, both through its potential application abroad and as a model for other countries examining the issue. Whether a distance education transmission initiated in one country and sent to a student in another country constitutes an infringement, falls within a collective or compulsory licensing scheme, or is exempted, will depend on which country's law a court applies. This means both that the scope of the exemptions in the U.S. Copyright Act may have an impact on foreign markets for U.S. works, and that U.S. copyright owners and users have an interest in the scope of exemptions or statutory licensing rules adopted in foreign laws.

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