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## Perfecting a Security Interest in Computer Software Copyrights: Getting It Right, 15 J. Marshall J. Computer & Info. L. 855 (1997)

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# PERFECTING A SECURITY INTEREST IN COMPUTER SOFTWARE COPYRIGHTS: GETTING IT RIGHT

## I. INTRODUCTION

Making, marketing, and ownership of computer software is the foundation of many prosperous companies.<sup>1</sup> Often times equipped with only ingenuity and bright ideas, these businesses require financial support from commercial lenders.

Lenders have typically shied away from lending money on the security of intellectual property because of the likely exposure to risk, instead preferring more "traditional, tangible collateral such as land, buildings, and equipment."<sup>2</sup> Today, lenders are being further discouraged by the confusion and complexity involved in perfecting a security interest<sup>3</sup> in

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1. Shawn K. Baldwin, Comment, *"To Promote The Progress of Science and Useful Arts: A Role for Federal Regulation of Intellectual Property As Collateral,"* 143 U. PA. L. REV. 1701, 1704 (1995) [hereinafter Baldwin]. "The value of intellectual property has risen substantially in recent years, to the point where, in many instances, a company's intellectual property is now far more valuable than its real property." *Id.* "As a result, intellectual property has earned recognition as the dominant factor behind many recent commercial transactions." *Id.*

Further proof of an increased awareness of intellectual property as an asset has been its "internationalization via multinational trade agreements." Melvin Simensky, *The New Role of Intellectual Property in Commercial Transactions*, 10 ENT. & SPORTS L. 5, 6 (1992). Prior to 1986, intellectual property was not covered by major trade agreements such as the General Agreement on Tariffs and Trade ("GATT"). *See id.* Today, intellectual property considerations can play an important role in trade negotiations. Industrialized nations attempt to condition the opening of their markets to other countries upon their citizens' intellectual property rights. *See id.* These changed perceptions of the commercial value of intellectual property were evidenced through trade sanctions imposed by the United States on China in early 1995 for China's failure to provide copyright and other legal protection for music, movies, software, and other imported U.S. products. Baldwin at 1738 n. 29 (citing Robert Hurtado, *With Sanctions Set, Companies Rethink Their China Plans*, N.Y. TIMES, Feb. 6, 1995, at A1, D2).

2. Baldwin, *supra* note 1.

3. Perfection is the process by which a secured party's security interest in a debtor's collateral is protected against competing claims to the collateral by third parties. DOUGLAS G. BAIRD & THOMAS H. JACKSON, *SECURITY INTERESTS IN PERSONAL PROPERTY* 66-67 (2d ed. 1987). For an overview of how a secured party may perfect a security interest in a debtor's collateral under the Uniform Commercial Code, see *id.* at 66-67.

the copyrights of computer software. Due to unclear laws, lenders may not know how to properly perfect a security interest. An unperfected security interest may translate into a great financial loss if a borrower files for bankruptcy.<sup>4</sup>

To perfect a security interest, a lender must, at minimum, record the interest according to federal law.<sup>5</sup> In the case of the borrower's bankruptcy, it is unclear as to how and where the lender must perfect its security interest. Two options for filing are presently available: under the Uniform Commercial Code ("U.C.C.") with the Secretary of State's Office<sup>6</sup> or under the Copyright Act with the U.S. Copyright Office.<sup>7</sup> Given the unclear state of the law, prudent lenders should file with both

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Perfection of a security interest is crucial because if the interest is not perfected, the secured party may lose its claim to the secured property as against judgment lien creditors, the trustee in a bankruptcy proceeding, or other third party creditors claiming an interest in the property. *Id.* at 67-68.

4. Where a transaction is financed by borrowed money, the lender usually seeks to secure the loan by obtaining a security interest in any property to which the debtor has title, including copyrights and other intellectual property. David A. Gerber et al., *The Role Of Intellectual Property In Mergers and Acquisitions*, 609 PLI/CORP. 537, 578 (1988). The perfection of security interests is particularly important when discussing its relationship to judicial liens. Elise B. May, Note and Comment, *Where Your Priorities Should Be: Analysis of the Perfection and Priority Of Security Interests In Copyrights As It Affects Bankruptcy*, 11 BANKR. DEV. J. 509, 514 (1994-95). Article 9 of the U.C.C. states the general rules of prioritizing security interests and judicial liens. *Id.* Under Article 9, an unperfected security interest is "subordinate to the rights of a person who becomes a judicial lien creditor before the security interest is perfected." *Id.* (citing U.C.C. § 9-301(b) (1990)). "If a general creditor brings a lawsuit against the debtor outside of bankruptcy, reduces its claim to judgment, and levies on the property before the unperfected secured creditor asserts its rights [perfects], the secured creditor will lose [its ownership interest]." *Id.* at 540 n.30 (quoting DOUGLAS G. BAIRD, *THE ELEMENTS OF BANKRUPTCY* 102 (1993)).

"Thus, if there can be judicial liens of copyrights, an unperfected security interest in a copyright would be subordinate to the rights of a person with a judicial lien on the copyright." *Id.* at 514.

5. See 17 U.S.C.A. § 205 (West 1996). See also *infra* note 6 (discussing the perfection of a security interest in tangible goods).

6. A security interest may be perfected in tangible goods by filing with the Secretary of State in the state where the debtor is located. U.C.C. § 9-101 (1996). Because legislation is currently unclear as to perfecting security interests in copyrights, a lender should file an interest in a copyright under both the U.C.C. and the Copyright Act.

7. Section 205 of the Copyright Act suggests that security interests in copyrights may be filed with the United States Copyright Office:

(a) Conditions for Recordation: Any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office if the document filed for recordation bears the actual signature of the person who executed it, or if it is accompanied by a sworn or official certification that it is a true copy of the original, signed document.

17 U.S.C.A. § 205 (West 1996).

the Secretary of State and with the Copyright Office.<sup>8</sup> The current state of the law does not answer these questions with the clarity and certainty needed to encourage the growth of investment in information and technological assets.<sup>9</sup> Borrowers and lenders are feeling the burden of dual filing and are forced to make sense of laws as they presently exist.

This comment aims to act as an aid for lenders in proclaiming and protecting their security interests in computer software copyrights. Part II explains how the Copyright Act protects computer software. This comment will discuss several methods of perfecting a security interest; under both the U.C.C. and the Copyright Act. Discrepancies between the U.C.C. and Copyright Act will be noted. In addition, relevant case law and court interpretation of principal issues will be addressed. *Peregrine Entertainment, Ltd. v. Capitol Federal Savings and Loan Ass'n of Denver*, provides a strong argument and precedent to support the federal filing of security interests in computer software copyrights.<sup>10</sup>

Much confusion exists in the area of security interests in intellectual property.<sup>11</sup> Part III will argue that federal law, under the Copyright Act, controls the filing of a security interest in a computer software copyright. Without a clear federal filing scheme, lenders and borrowers alike suffer.<sup>12</sup> Lenders put themselves at risk, never knowing whether their interest in a computer program is secure,<sup>13</sup> and thus may become unwilling to finance technology-based companies. As a result, borrowing companies may find that financing is unavailable and, therefore, would be unable to continue to develop new programs.<sup>14</sup> If a federal filing scheme is not recognized and followed, society as a whole will suffer when our nation is unable to compete in the on-going race of technological advancement.

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8. See May, *supra* note 4, at 523. See also Steven Weinberger, *Perfection of Security Interests in Copyrights: The Effect on the Orion Pictures Plan of Reorganization*, 11 CARDOZO ARTS & ENT. L.J. 959, 986 (advocating a "mixed" approach to recording by combining the U.C.C. and the Copyright Act, thus requiring filing both at the state level under the U.C.C. and filing at the federal level with the Copyright Office); see, e.g., 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 10.05 [A], 10-52 (1996) (stating that "in the absence of clearer judicial authority, a prudent approach would be to comply with both the federal requirements and also with any applicable state provisions relating to execution and recordation of chattel mortgages").

9. May, *supra* note 4.

10. *In re Peregrine Entertainment, Ltd. v. Capitol Federal Savings and Loan Ass'n of Denver*, 116 B.R. 194 (Bankr. C.D. Cal. 1990) (holding that in order to perfect a security interest in a copyright, the interest must be filed with the United States Copyright Office).

11. Baldwin, *supra* note 1, at 1707-08.

12. Baldwin, *supra* note 1, at 1707.

13. Baldwin, *supra* note 1, at 1708.

14. See generally Baldwin, *supra* note 1, at 1704-08 (setting forth specific illustrations demonstrating the importance of intellectual property to corporations).

As an aid in making sense of the current federal filing system, the reader is given step-by-step instructions on how to successfully perfect a security interest in computer software copyrights. Finally, this comment poses potential problems and suggests solutions.

## II. BACKGROUND

For over a century, intellectual property<sup>15</sup> has served as collateral in securing financing.<sup>16</sup> Successful inventors and entrepreneurs, such as Thomas Edison, used their inventions as collateral to borrow money to start companies.<sup>17</sup> Similarly, contemporary small and large businesses still use creative inventions, namely computer software, as collateral in securing loans to further expand their operations.<sup>18</sup> In order to safeguard their creations, authors of computer software programs copyright<sup>19</sup> their material; these computer software copyrights are entitled to protection under the Copyright Act of 1976.<sup>20</sup>

### A. COMPUTER SOFTWARE UNDER THE COPYRIGHT ACT

The Copyright Act of 1976 did not directly acknowledge how rapidly advancing computer technology might fit into the copyright protection scheme.<sup>21</sup> However, the House Report for the 1976 Act explicitly included computer programs within the "literary works"<sup>22</sup> category of the

15. The term "intellectual property" in this comment refers to patents, trademarks subject to federal statutes, and, most relevant for purposes of this Comment, copyrights. Mask works, a type of intellectual property relating to computer circuitry, will also be discussed in that federal statutory regulation provides for federal recordation of security interests. See Semiconductor Chip Protection Act of 1984, 17 U.S.C. §§ 901-914 (1993).

16. Baldwin, *supra* note 1, at 1701.

17. Baldwin, *supra* note 1, at 1701.

18. Michael E.C. Moss, "Financing Information-Technology Solutions," 12 No. 5 COMPUTER LAW. 24 (1995). "Although it is not the ideal collateral, technology may serve as the most meaningful collateral. Thus, the lending community will no longer have a choice of whether to finance software, because software is the critical component of the modern information system and debt will always be essential to commerce." *Id.*

19. A "copyright" is defined as "[a]n intangible, incorporeal right granted by statute to the author or originator of certain literary or artistic productions, whereby he is invested, for a specific period, with the sole and exclusive privilege of multiplying copies of the same and publishing and selling them." BLACK'S LAW DICTIONARY 336 (6th ed. 1990). See *infra* notes 20 and 23 (discussing "literary works" and the definition thereof).

20. Computer programs and software fall under the "literary works" category of the Copyright Act. See *infra* note 1, at 1701 (discussing "literary works" and the meaning thereof).

21. The 1976 Copyright Act did not specifically include computer programs in its categories of protected works of authorship. See 17 U.S.C.A. § 102(a) (West 1996).

22. See *Atari Games Corp. v. Nintendo America Inc.*, 975 F.2d 832, 838 (Fed. Cir. 1992) (stating the statutory definition of "literary works"). "Literary works" are works, other than audiovisual works, expressed in words, numbers, or other verbal or numerical sym-

Copyright Act.<sup>23</sup> As recommended by the National Commission on New Technological Uses of Copyrighted Works ("CONTU"), the 1980 amendments to the Copyright Act unambiguously extended copyright protection to computer programs.<sup>24</sup> It is now undisputed that computer programs are copyrightable.<sup>25</sup>

Upon obtaining a copyright, owners of copyrighted works have the right to reproduce their own work;<sup>26</sup> prepare derivative works;<sup>27</sup> distribute, sell, lease, or loan copies of their own work;<sup>28</sup> distribute copies to the public by sale, rental, lease, or lending;<sup>29</sup> display their own work;<sup>30</sup>

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bols or indicia, regardless of the nature of the material objects, such as books, periodicals, manuscripts, phonorecords, film, tapes, disks, or cards, in which they are embodied." *Id.* (citing H.R. REP. NO. 1476, 94th Cong., 2d Sess. 54 (1976). "The term 'literary works' does not connote any criterion of literary merit or qualitative value: it includes . . . computer data bases, and computer programs to the extent that they incorporate authorship in the programmer's expression of original ideas, as distinguished from the ideas themselves." *Id.*

23. 17 U.S.C.A. § 102(a) The subject matter of copyright is defined as follows:

(a) Copyright protection subsists, in accordance with this title, in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Works of authorship include the following categories:

- (1) Literary works;
- (2) musical works, including any accompanying words;
- (3) dramatic works, including any accompanying music;
- (4) pantomimes and choreographic works;
- (5) pictorial, graphic, and sculptural works;
- (6) motion pictures and other audiovisual works;
- (7) sound recordings; and
- (8) architectural works.

*Id.*

These eight categories are not exclusive. H.R. REP. NO. 94-1476, 94th Cong., 2d Sess. (1976). The list of protected categories does not exhaust the scope of protected works. "Rather, the list sets out the general area of copyrightable subject matter, but with sufficient flexibility to free the courts from rigid or outmoded concepts of the scope of particular categories." *Id.* The Copyright Act does not protect the ideas, principles or procedures embodied in the protected expression. 17 U.S.C.A. § 102(a). Thus, the Copyright Act attempts to provide a flexible definition of the subject matter entitled to copyright protection. *Id.* Only with the passage of time will tell if this definition is flexible enough to keep up with emerging technologies. *Id.*

24. *Sega Enter. Ltd. v. Accolade, Inc.*, 977 F.2d 1510, 1519 (9th Cir. 1992) (citing Pub.L 96-517, 94 Stat. 3028 (codified at 17 U.S.C. §§ 101, 177 (1980)); see National Commission on New Technological Uses of Copyrighted Works, Final Report 1 (1979) (hereinafter "CONTU Report").

25. See *supra* notes 22 and 24 (supporting the proposition that computer programs are entitled to copyright protection).

26. 17 U.S.C.A. § 106(1) (West 1996).

27. 17 U.S.C.A. § 106(2) (West 1996).

28. 17 U.S.C.A. § 106(3) (West 1996).

29. 17 U.S.C.A. § 106(4) (West 1996).

30. 17 U.S.C.A. § 106(5) (West 1996).

and perform their own work.<sup>31</sup> Thus, an owner of a computer software copyright controls valuable entitlements. Indeed, these entitlements translate into sizable bargaining power when securing financing.<sup>32</sup>

## B. SECURITY INTERESTS

### 1. *The Uniform Commercial Code*

Most security interests<sup>33</sup> are filed and perfected under the Uniform Commercial Code.<sup>34</sup> The drafters of the U.C.C. designed Article 9 to regulate agreed upon transactions involving personal property as collateral.<sup>35</sup> Under Article 9, a debtor who grants a security interest in personal property retains an ownership interest in the secured property. While the debtor retains the right to transfer ownership rights in the

31. 17 U.S.C.A. § 106(6) (West 1996).

32. See generally Baldwin, *supra* note 1, at 1704-08 (setting forth specific situations which illustrate the value of intellectual property rights).

33. U.C.C. § 1-201(37) (1996). "Security interest" is defined in § 1-201(37) of the Uniform Commercial Code:

'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (2-401) is limited in effect to a reservation of a 'security interest.' The term also includes any interest of a buyer of accounts or chattel paper which is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under § 2-401 is not a 'security interest', but a buyer may also acquire a 'security interest' by complying with Article 9. Unless a consignment is intended as security, reservation of title thereunder is not a 'security interest', but a consignment in any event is subject to the provisions on consignment sales (§ 2-326). Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and (a) the original term of the lease is equal to or greater than the remaining economic life of the goods, (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods, (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration upon compliance with the lease agreement, or (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

*Id.*

34. May, *supra* note 4, at 511.

35. U.C.C. § 9-101 cmt. (1996). "... [A]rticle [Nine] sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures." *Id.* But see U.C.C. § 9-104 (1996) (listing various transactions excluded from Article 9). The term "collateral" is defined as "property which is pledged as security for the satisfaction of a debt." BLACK'S LAW DICTIONARY 261 (6th ed. 1990). § 9-105 of the U.C.C. defines "collateral" as "property subject to a security interest, and includes accounts and chattel paper which have been sold." U.C.C. § 9-105(c) (1996).

collateral,<sup>36</sup> the transferee must take the collateral subject to any perfected security interest.<sup>37</sup>

A lender must painstakingly ensure that its security interest in collateral is properly perfected.<sup>38</sup> Proper perfection is the only protection against future holders of the intellectual property.<sup>39</sup> The U.C.C. states that security interests in general intangibles,<sup>40</sup> which include patents, trademarks and copyrights,<sup>41</sup> may be perfected by filing a financing statement<sup>42</sup> with the proper state authorities, usually the office of the

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36. U.C.C. § 9-311 (1996). "The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." *Id.*

37. *See* U.C.C. § 9-306(2) (1996) ". . . [A] security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor." *Id.*

38. Baldwin, *supra* note 1, at 1708.

39. Baldwin, *supra* note 1, at 1708.

40. *See* U.C.C. § 9-106 (1996). "General intangibles' means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit and money." *Id.*

Article 9 further provides that a security interest may be perfected in such property by filing evidence thereof with the office of the Secretary of State of the state in which the debtor is located. U.C.C. § 9-101 (1996). *But see* U.C.C. §§ 9-401(1)(c) (1996) and 9-302(1) (1996) (generally supporting the preemption of the U.C.C. when property is governed by federal statute in this case).

41. *See* U.C.C. § 9-106 cmt. "[E]xamples [of general intangibles] are copyrights, trademarks and patents, except to the extent that they may be excluded by § 9-104(a)." *Id.* *See also* Paul A. Baumgarten, *Copyrights Collateral: Perfection Finally Perfected After Peregrine?*, 71 U. DET. MERCY L. REV. 581, 585 (1994) (discussing "general intangibles" and § 9-106).

42. The financing statement is a "document setting out a secured party's security interest in goods. A document designed to notify third parties, generally prospective buyers or lenders, that there may be an enforceable security interest in the property of the debtor." BLACK'S LAW DICTIONARY 631 (6th ed. 1990). *See* BAIRD & JACKSON, *supra* note 3, at 189, (stating that the financing statement "exists to aid third parties"); *see also* U.C.C. § 9-402 (1996):

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, given an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches . . . A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by the debtor.

*Id.* *See also* U.C.C. §§ 9-402(2) - (8) for further formal requisites of a financing statement. If perfection of a security interest is achieved by filing, the financing statement is the document that is usually filed for this purpose. A single page form to be filed as a financing statement has been designed by the Secretary of State of each state. Copies of the form may be obtained from the Secretary of State's office or from legal form supply houses within each state.



Secretary of State.<sup>43</sup> Given this broad statement, it might seem that the U.C.C. is an appropriate system by which to perfect a security interest in a copyright.<sup>44</sup> In addition, section 9-104's Official Comment, which excludes certain security interests from compliance with Article 9,<sup>45</sup> explains that this exclusion does not apply to a security interest in a copyright.<sup>46</sup> This Official Comment may be outdated, however, since it

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ELDON H. REILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 3.02[4] (2d ed. 1989).

43. See U.C.C. § 9-103(3) (1996) (indicating which state's law governs the perfection of security interests in general intangibles).

(a) This subsection applies to . . . general intangibles (other than uncertificated securities) . . . .

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States, and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or non-perfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor . . . .

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence . . . .

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

*Id.* See also § 9-401 (setting forth the proper place to file in order to perfect a security interest). Relevant portions of § 9-401 provide the following:

(1) The proper place to file in order to perfect a security interest is in the office of the [Secretary of State] . . . .

(2) A filing which is made in good faith in an improper place or not in all of the places required by this is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this Article [Nine] and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed . . . .

*Id.*

44. Baumgarten, *supra* note 41, at 585.

45. U.C.C. § 9-104(a). "This Article does not apply to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property . . . ." *Id.*

46. *Id.* (discussing when Article 9 does not apply to a security interest).

was drafted at the time the 1909 Copyright Act was in effect.<sup>47</sup> If the U.C.C. clearly provided the only method of perfecting a security interest in a copyright, no confusion would exist.<sup>48</sup> However, the Copyright Act includes its own provisions governing transfers of ownership interests.<sup>49</sup>

## 2. *The Copyright Act*

The Copyright Act provides an auxiliary method to perfect a security interest in a copyright.<sup>50</sup> Section 205 of the Copyright Act governs the recordation of copyright transfers and establishes priority among conflicting copyright transfers as well as for any other document "pertaining to a copyright."<sup>51</sup> Though not specifically stated in the Copyright Act, a security interest in a copyright is arguably a copyright transfer.<sup>52</sup> Section 101 of the Copyright Act states that a "transfer of copyright owner-

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47. Baumgarten, *supra* note 41, at 595 n.21 (citing U.C.C. § 9-104(a) cmt. 1). The Official Comment provides the following:

Although the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright (17 U.S.C. §§ 28, 30) such a statute would not seem to contain sufficient provisions regulating the rights of the parties and third parties to exclude security interest in copyrights from the provisions of this Article . . . The filing provisions under these Acts . . . are recognized as the equivalent to filing under this Article.

U.C.C. § 9-104(a) cmt. 1 (1996).

48. *See infra* text Part III(A) for a discussion of the benefits of a federal filing system. The most common error lenders have made in the recent past is filing under only Article 9 of the U.C.C. Lenders have failed to recognize that courts have recently favored federal filing under the Copyright Act. *See* Peregrine Entertainment, Ltd. v. Capital Fed. Sav. and Loan Ass'n of Denver (*In re* Peregrine Entertainment, Ltd.) 116 B.R. 194 (C.D. Cal 1990) (holding that in order to perfect a security interest in a copyright, a filing must be made in the Copyright Office under the Copyright Act). U.C.C. filing, by itself, is insufficient. *Id.*

49. *See* 17 U.S.C. § 205 (West 1995) (providing for recordation of any document transferring ownership in a copyright or any other document pertaining to a copyright).

50. *Id.* Case law supports the controlling of the Copyright Act in perfecting security interests in copyrights. *See* Peregrine Entertainment, Ltd. v. Capitol Federal Savings and Loan Association of Denver (*In re* Peregrine Entertainment), 116 B.R. 194 (Bankr. C.D. Cal. 1990) (holding that in order to perfect a security interest in a copyright, the interest must be filed with the United States Copyright Office).

51. 17 U.S.C.A. § 205(a) (West 1996).

### Recordation of transfers and other documents

(a) Conditions for Recordation. Any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office if the document filed for recordation bears the actual signature of the person who executed it, or if it is accompanied by a sworn or official certification that it is a true copy of the original, signed document.

*Id.*; *see* May, *supra* note 4, at 512. *See also* Nancy Bellhouse May, *Belts or Suspenders? Perfecting a Security Interest In A Trademark or Copyright*, 27-SPG. ARK. LAW. 8, 10 (1993) (stating that security interests in registered copyrights must be recorded at the Copyright Office, noting 17 U.S.C. § 205 (providing for recordation of any document transferring ownership in a copyright or any other document pertaining to a copyright)).

52. May, *supra* note 4, at 512.

ship" broadly includes any "assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation<sup>53</sup> of a copyright . . . whether . . . it is limited in time or place of effect."<sup>54</sup> Given the language of § 101, the granting of a security interest would appear to be covered by the Copyright Act.<sup>55</sup>

At minimum, a security interest agreement in a copyright qualifies as a "document which pertains to a copyright."<sup>56</sup> The Copyright Office states that a document is pertinent to a copyright, "if it has a direct or indirect relationship to the existence, scope, duration, or identification of a copyright, or to the ownership, division, allocation, licensing, transfer, or exercise of rights under a copyright. That relationship may be past, present, future or potential."<sup>57</sup> This language expresses the Copyright Office's intention that there be voluntary transfers in copyrights, including creditors taking a security interest in computer software copyrights.<sup>58</sup>

### 3. *Reconciling the differences: U.C.C. § 9-302 and the Accompanying Official Comment*

While it has previously been implied in this comment that a lender may file a security interest in computer software copyrights under either the U.C.C. or the Copyright Act, U.C.C. § 9-302(3) and its Official Comment suggest that filing under the U.C.C. is improper.<sup>59</sup> Whether the U.C.C. applies to a particular transaction depends on whether the parties' substantive rights are governed by federal statutes.<sup>60</sup> Contrary to U.C.C. §§ 9-104 (stating that Article 9 is superseded only to the extent of federal coverage),<sup>61</sup> §§ 9-302(3)<sup>62</sup> and the accompanying Official Com-

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53. BLACK'S LAW DICTIONARY 742 (6th ed. 1990) (defining "hypothecate" as "[t]o pledge property as security or collateral for a debt").

54. 17 U.S.C.A. § 101 (West 1996). A mortgage can be defined as "a pledge or security of particular property for the payment of a debt." BLACK'S LAW DICTIONARY 1010 (6th ed. 1990).

55. See 17 U.S.C.A. § 101 (West 1996) (setting forth definitions within the scope of copyrights, including the definition of a transfer of copyright ownership).

56. May, *supra* note 4, at 513.

57. May, *supra* note 4 at 512 (quoting 37 C.F.R. § 201.4(a)(2) (1992)).

58. See *Peregrine*, 116 B.R. at 199 (C.D. Cal. 1990); *AEG Acquisition Corp. v. Zenith Prods. Ltd. (In re Acquisition Corp.)*, 127 B.R. 34, 41 (Bankr. C.D. Cal. 1991).

59. U.C.C. § 9-302(3) (1996). See *infra* notes 62 and 63 (setting forth U.C.C. § 9-302(3) and its official comment, respectively).

60. See U.C.C. §§ 9-104(a). "Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statutes and excluded from this Article." *Id.* § 9-104(a) cmt. 1 (1996). For further discussion of the U.C.C. step-back provisions, see generally BAIRD & JACKSON, *supra* note 3, at 153-164 (discussing exclusions from the U.C.C. based on federal statutes).

61. U.C.C. § 9-104(a) lists one among several transactions excluded from Article 9. "This Article does not apply: (a) to a security interest subject to any statute of the United

ment suggest that the U.C.C.'s scope does not extend to the perfection of security interests in copyrights.<sup>63</sup>

Although U.C.C. § 104's characterization of the limited scope of the Copyright Act may have been true under the Copyright Act of 1909,<sup>64</sup> the Revised Copyright Act of 1976 is broader.<sup>65</sup> The Revised Act enlarges filing privileges to any "document pertaining to a copyright" if it is an originally signed document or if it is submitted with sworn or official certification that it is a true copy.<sup>66</sup> Judges, critics, and scholars argue that in order to perfect a security interest in the copyrights of computer software, a lender must file its interest with the Copyright Office. Existing case law tends to support this conclusion.<sup>67</sup>

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States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." *Id.*

62. U.C.C. § 9-302 (1996).

When Filing Is Required to Perfect Security Interest; Security Interests to Which Filing Provisions of This Article Do Not Apply:

(3) The filing of a financing statement otherwise required by this Article is not necessary or effective to perfect a security interest in property subject to (a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this Article for filing of the security interest . . . .

U.C.C. § 9-302 (1996).

63. *See* U.C.C. § 9-302 cmt. 8. The Official Comment provides the following:

Sub (3) exempts from the filing provisions of this Article transactions as to which an adequate system of filing, state or federal, has been set up outside this Article and sub (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system . . . .

*Id.* (implying that filing under Article [Nine] is not a permissible alternative). Examples of the type of federal statute referred to in paragraph (3)(a) are the provisions of 17 U.S.C.A. §§ 28, 30 (copyrights). *Id.*

64. The Copyright Act of 1909 restricted the availability of recording to "assignments." THE LAW AND BUSINESS OF COMPUTER SOFTWARE § 27.06 (D.C. Toedt III ed., 1991) (citing 17 U.S.C. § 30 (West 1996)).

65. *Id.* at § 27.06.

66. *Id.* (citing 17 U.S.C.A. § 205). "The revised Copyright Act arguably preempts Article 9." *Id.* at 27-06.1. Any document, including a security interest agreement, can now be filed if it is properly signed. *Id.* The 1976 Act provides priority rules, and thus, it would seem that the U.C.C. Official Comments regarding the inadequacy of the Copyright Act (§ 9-104 cmt.) are obsolete. *Id.* This conclusion is supported by the legislative history relating to the recordation provision of the Semiconductor Act which was based on the same provision in the Revised Act. *Id.* (citing *Explanatory Memorandum - Mathias-Leahy Amendment to S1201*, 130 CONG REC. S12917 (daily ed. Oct. 3, 1984)). The Semiconductor Act adopts the provision of the revised act virtually word for word. *Id.* The Senate Memorandum discussing the Semiconductor Act states that the Copyright Office is the appropriate place to record security interests under the U.C.C. *Id.* By analogy, the Copyright Office is the appropriate place to record security interests in [computer software] copyrights. *Id.*

67. *See* 116 B.R. 194 (1990) (holding that in order to perfect a security interest in a copyright, a filing must be made in the Copyright Office under the Copyright Act. *See also*

## C. CASE LAW

Little case law exists with respect to the perfection of a security interest in copyrights. Even less case law exists with respect to perfection of a security interest in computer software copyrights. Prior to *The Peregrine Producers Group, Inc. v. Capital Federal Savings and Loan Association of Denver*,<sup>68</sup> "no case fully discussed the issue of whether federal law preempts state law or whether state law governs the perfection of copyrights."<sup>69</sup>

1. *The Peregrine Case*

The Capital Federal Savings & Loan Association ("Capital") entered into a security agreement with American National Enterprises, Corp. ("ANE"), a film distribution company, which extended to Capital a \$6 million line of credit.<sup>70</sup> Under the security agreement, Capital took a security interest in collateral owned by ANE, including the "copyrights, distribution rights and licenses to approximately 145 films, and accounts receivable arising from the licensing of these films to various programmers,"<sup>71</sup> in addition to films procured by ANE after the loan date.<sup>72</sup> In 1986, ANE merged into National Peregrine, Inc. ("NPI").<sup>73</sup> Amendments to the original loan agreement extended Capital's credit line to NPI.<sup>74</sup> In extending the credit, Capital filed U.C.C. financing statements in three states.<sup>75</sup> However, no filings were made in the Copyright Office.<sup>76</sup>

In 1989, NPI filed a voluntary petition in bankruptcy.<sup>77</sup> NPI, as debtor in possession,<sup>78</sup> claimed that Capital, in failing to record a mort-

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AEG Acquisition Corp. v. Zenith Prod. Ltd., 127 B.R. 34 (Bankr. C.D. Cal. 1991) (supporting the finding of the *Peregrine* court).

68. *Peregrine*, 116 B.R. 194 (1990).

69. Baumgarten, *supra* note 41, at 586.

70. *Peregrine*, 116 B.R. at 197.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. See Steven Weinderger, *Perfection of Security Interests in Copyrights: The Peregrine Effect On the Orion Pictures Plan of Reorganization*, 11 CARDOZO ARTS & ENT. L.J. 959, 963 (1993) (naming the three states in which filing statements were filed: California, Colorado, and Utah).

76. *Peregrine*, 116 B.R. at 198 (1990).

77. *Id.* "Bankruptcy" refers to the state or condition of a person (individual, partnership, corporation, municipality) who is unable to pay its debts as they are, or become, due. The condition of one whose circumstances are such that he is entitled to take the benefit of federal bankruptcy laws." BLACK'S LAW DICTIONARY 147 (6th ed. 1990).

78. "Debtor in possession" means debtor except when a person that has qualified under 322 of [the Bankruptcy Code] is serving as trustee in the case." 5 COLLIER ON BANKRUPTCY §§ 1101.01, 1101-1 to 1101-2 (Lawrence P. King ed., 15th ed. 1996) (quoting 11 U.S.C.A. § 1101 (West 1996)). "Unless the court orders the appointment of a trustee under

gage of copyright in the Copyright Office, had not perfected its security interest in the collateral and that the assignment of such collateral was voidable<sup>79</sup> under the Bankruptcy Code.<sup>80</sup>

The United States bankruptcy court interpreted the 1976 Copyright Act as permitting either a Copyright Office filing or a U.C.C. filing.<sup>81</sup> The court held that the state U.C.C. filing was sufficient to perfect Capital's security interest.<sup>82</sup>

On appeal, the district court reversed the bankruptcy court, holding that the 1976 Act and the U.C.C. *were not* interchangeable means of perfecting a security interest in copyrights and that the 1976 Act required a Copyright Office filing in order to perfect an interest.<sup>83</sup> The court strongly favored the Copyright Act's preemption of the U.C.C.<sup>84</sup> when filing security interests in copyrights.<sup>85</sup>

In analyzing the U.C.C., the district court found a difference between the 1976 Copyright Act and the U.C.C. with regard to the priority of conflicting transfers.<sup>86</sup> Because of this difference, filing under the U.C.C. would "undermine the priority scheme Congress had established under the 1976 Act."<sup>87</sup> The district court concluded that this "type of

1104(a), the debtor in a chapter 11 case will remain in possession of its property during the chapter 11 case." *Id.* at 1101-02. "After entry of an order for relief, the debtor is a 'debtor in possession' until the court orders the appointment of a trustee under § 1104(a), a trustee is appointed under § 1104(d), and the person appointed qualifies under § 322 of the Code." *Id.* at 1101-02 to 1101-03. For example, in a Chapter 11 case "either the debtor will remain in control of its business or assets, or a trustee will be appointed to take control of the business or assets." BLACK'S LAW DICTIONARY 404 (6th ed. 1990).

79. BLACK'S LAW DICTIONARY 1574 (6th ed. 1990). "Voidable" is "that which may be avoided . . . It imports a valid act which may be avoided rather than an invalid act which may be ratified." *Id.*

80. 116 B.R. at 198. The Bankruptcy Code is a federal law (11 U.S.C.) "for the benefit and relief of creditors and their debtors" in cases in which the debtors are unable or unwilling to pay their debts. BLACK'S LAW DICTIONARY 146 (6th ed. 1990).

81. 116 B.R. at 201.

82. *Id.* at 203.

83. *Id.* (explaining the standard of review).

84. *Id.* at 199. The court states that "federal copyright laws ensure 'predictability and certainty of copyright ownership,' 'promote national uniformity,' and 'avoid the practical difficulties of determining and enforcing an author's rights under the differing laws and in the separate courts of the various States.'" *Peregrine*, 116 B.R. at 199.

85. *Id.* The court also noted that a secured party need only file with the Copyright Office in order to give constructive notice of the facts in recorded documents. *Id.* Thus, a party interested in the copyright need only search records kept by the Copyright Office to determine whether a copyright is encumbered. *Id.* at 200. Also, "interested third parties could never be sure that all relevant jurisdictions have been searched." *Peregrine*, 116 B.R. at 200. The tediousness of adequately searching every relevant jurisdiction, "together with the expense and delay of conducting searches in a variety of jurisdictions, could hinder the purchase and sale of copyrights . . ." *Id.*

86. Baumgarten, *supra* note 41, at 588 (citing *Peregrine*, 116 B.R. at 200).

87. Baumgarten, *supra* note 41, at 588 (citing *Peregrine*, 116 B.R. at 201).

direct interference with the operation of federal law weighs heavily in favor of preemption."<sup>88</sup>

The district court further analyzed U.C.C. § 9-302(3)(a),<sup>89</sup> which states that an Article 9 filing is not necessary where property is subject to a "national or international registration scheme or which specifies a place different from that specified in Article 9." The court emphasized that the Copyright Act establishes a national system for recording transfers of copyright interest and specifies a place to file different from Article 9.<sup>90</sup> Noting the already established federal filing system, the court held that recording in the Copyright Office is the appropriate method of recording security interests in a copyright.<sup>91</sup>

The rule set forth by the district court is as follows:

When a federal statute provides for a national system of recordation or specifies a place of filing different from that in Article 9, the methods of perfection specified in Article 9 are supplemented by that national system; compliance with national system of recordation is equivalent to the filing of a financing statement under Article 9.<sup>92</sup>

## 2. *In Re AEG Acquisition Corporation*

One year after the *Peregrine* decision, the United States Bankruptcy Court for the Central District of California addressed whether a security interest in a copyright must be recorded under the Copyright Act in order to be perfected.<sup>93</sup> AEG Acquisition Corporation ("AEG") was a chapter 11 debtor with principal asset motion picture copyrights.<sup>94</sup> In 1987, AEG's predecessor, Atlantic Entertainment Group, Inc., acquired the distribution rights for three motion pictures from Zenith Productions.<sup>95</sup> Upon Atlantic's failure to pay Zenith the guaranteed amounts as per the agreements, the parties renegotiated the contracts, and Atlantic executed a confession of judgment<sup>96</sup> for \$6 million.<sup>97</sup>

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88. *Peregrine*, 116 B.R. at 201. The court distinguished U.C.C. § 9-104 in several ways: (1) the place of filing and aspects of enforcing or dealing with security interests were separate issues; (2) § 205 of the 1976 Copyright Act is much more detailed than § 30 of the 1909 Act; and (3) the commentary to § 9-104 addresses the 1909 Act and not the 1976 Act. *Id.* at 202-03. For further discussion of § 9-104, see *supra* note 60 and 61.

89. See *supra* note 62 (setting forth U.C.C. § 9-302(3)(a) (1994)).

90. *Peregrine*, 116 B.R. at 203 (quoting U.C.C. § 9-302(3)(a) (1990)). The court noted that "the drafters of the U.C.C. specifically identified the 1976 Copyright Act as establishing a national system." U.C.C. § 9-302 cmt. 8. See also *supra* note 63.

91. *Peregrine*, 116 B.R. at 203.

92. Baumgarten, *supra* note 41, at 589 (citing U.C.C. § 9-302(4) (1990)).

93. *AEG Acquisition Corp. v. Zenith Prod. Ltd.*, 127 B.R. 34 (Bankr. C.D. Cal. 1991).

94. *Id.* at 37.

95. *Id.*

96. *AEG Acquisition Corp.*, 127 B.R. at 34A. "Confession of judgment" is a "[w]ritten authority of [a] debtor and his direction for entry of judgment against him in the event he shall default in payment." *Id.* "Such a provision in a debt instrument . . . permits the

Kartes Video Communications, Inc. ("KVC") procured Atlantic and renamed it AEG.<sup>98</sup> Zenith then entered into a new agreement with KVC whereby AEG would reacquire the motion picture distribution rights for \$6 million.<sup>99</sup> Although the contract required a confession of judgment<sup>100</sup> it also required destruction of the judgment upon payment of all sums under the agreement.<sup>101</sup>

In addition, AEG gave Zenith a security agreement in the motion pictures.<sup>102</sup> Zenith then filed U.C.C. financing statements in three separate states.<sup>103</sup> Zenith also recorded a copyright mortgage in the Copyright Office for each of the films but only obtained a copyright registration for one of the films.<sup>104</sup> According to plan, AEG made payments to Zenith on April 12 and May 10, 1989.<sup>105</sup> But on July 28, 1989, AEG filed a bankruptcy chapter 11 petition.<sup>106</sup> Thereafter, AEG filed an adversary proceeding<sup>107</sup> against Zenith to recover the more than \$2,000,000 in payments made to Zenith.<sup>108</sup>

The court followed *Peregrine*, in holding that a security interest in a copyright in a film could be perfected only under the United States Copyright Act.<sup>109</sup> The first to execute a security interest in compliance with C.F.R. § 205(c)<sup>110</sup> prevails when conflicting transfers arise.<sup>111</sup> Thus,

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creditor or his attorney on default to appear in court and confers judgment against the debtor." BLACK'S LAW DICTIONARY 259-60 (6th ed. 1990).

97. *AEG*, 127 B.R. at 37.

98. *Id.*

99. *Id.*

100. See *supra* note 96 (defining a "confession of judgment").

101. *AEG*, 127 B.R. at 37.

102. *Id.*

103. *Id.* at 37-38

104. *Id.*

105. *Id.*

106. *AEG*, 127 B.R. at 38.

107. BLACK'S LAW DICTIONARY 52 (6th ed. 1990) (defining an "adversary proceeding" as a proceeding "having opposing parties; contested, as distinguished from an *ex parte* hearing or proceeding of which the party seeking relief has given legal notice to the other party, and afforded the latter an opportunity to contest it").

108. *AEG*, 127 B.R. at 38.

109. *Id.* at 40 (indicating that filing under the U.C.C. would be ineffective and improper). "A security interest in a film is perfected under the United States Copyright Act, and not under the Uniform Commercial Code . . . The Copyright Act preempts the U.C.C. for security interests in films. Thus Zenith's filing of its U.C.C.-1 gave it no assistance in perfecting its security interest in these motion pictures." *Id.* at 40-41. The court acknowledged that the "Copyright Act states that 'any transfer of copyright ownership or other document pertaining to a copyright' may be recorded in the United States Copyright Office." *Id.* at 41. See also 17 U.S.C.A. § 205(a) (West 1996) (defining conditions for recordation).

110. 17 U.S.C.A. §205(c) (West 1996).

Recordation of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document, but only if:



because Zenith failed to perfect its security interest in the copyrights, the court permitted AEG to recover payments made for distribution rights in unregistered foreign films.<sup>112</sup>

### III. ANALYSIS

Current law does not adequately protect and inform lenders in securing interests in the copyrights of computer software programs.<sup>113</sup> This legal inadequacy is due largely to the conflicting and puzzling language used in Article 9 of the U.C.C.<sup>114</sup> The conflict would be resolved by adopting the federal approach of securing copyright interests through the United States Copyright Office rather than through the Secretary of

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- (1) 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 title or registration number of the work; and,
  - (2) the registration has been made for the work.

*Id.*

111. *AEG*, 127 B.R. at 41. 17 U.S.C.A. § 205(d) (West 1996) discusses priority between conflicting transfers:

As between two conflicting transfers, the one executed first prevails if it is recorded, in the 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.

17 U.S.C.A. § 205(d) (West 1996).

Following *Peregrine*, the *AEG* court stated that "under § 544(a)(1) of the Bankruptcy Code, the debtor's hypothetical judicial lien entitles it to prevail over holders of security interests not perfected under the Copyright Act." *AEG*, 127 B.R. at 40. A "judicial lien" is "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 2 COLLIER ON BANKRUPTCY, *supra* note 78, ¶ 101.36, 101-18. Within the meaning of Bankruptcy Code lien avoidance, a lien is "a charge against or an interest in property to secure payment of a debt, obtained by judgment or other legal proceedings." BLACK'S LAW DICTIONARY 848 (6th ed. 1990).

112. *AEG*, 127 B.R. at 40. Zenith, the creditor, had contended that the registration of two of the films was not necessary to perfect its security interest because, as foreign films, they are governed by the Berne Convention Act. *Id.* at 41-42. However, Zenith needed to comply with domestic United States law to perfect its security interest in foreign films. *Id.* at 42.

113. Confusing and contradictory language is used throughout the statutes and official comments of the U.C.C. when discussing the perfection of security interests in copyrights.

114. U.C.C. § 9 (1996). While it might seem as though copyrights of computer programs would be classified as "general intangibles" under U.C.C. §§ 9-101, 9-104(a) and 9-302(3) suggest that the Copyright Act of 1976 would preempt the U.C.C. These sections generally state that when a United States Statute exists, governing the security interest, Article 9 of the U.C.C. would not apply. U.C.C. §§ 9-104(a), 9-302(3) (1996). The Copyright Office provides for a national registration of copyrights. 17 U.S.C.A. (West 1996). Thus, the Copyright Act may be said to preempt the U.C.C.

State under the U.C.C. To aid lenders in perfecting security interests in computer software programs through the Copyright Office, a step-by-step guide follows. Admittedly, problems with this approach exist. Additionally, suggestions for resolving these problems are given, and current trends in the law are noted.

A. Federal Filing: Best Method for Perfecting a Security Interest in Software Copyrights

An entirely federal system, preempting the U.C.C., would provide the certainty now lacking when filing a security interest in computer software copyrights. Resolving existing confusion and pronouncing a federal system requires passage of legislation by Congress.<sup>115</sup> As a result of federal legislation, parties involved in an intellectual property financing transaction would benefit from uniform rights throughout the United States.<sup>116</sup> The lender would not have the burden of filing multiple financing statements in several states, and verifying ownership interests could be as simple as running a search through *one* office. The Copyright Reform Act of 1993,<sup>117</sup> introduced, but never passed, in both the House and Senate, unsuccessfully attempted to clarify legislative intent (proposing an overturning of *Peregrine*).<sup>118</sup>

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115. Baldwin, *supra* note 1, at 1732.

116. *Id.*

117. See 139 CONG. REC. E337-01 (1993) (statement of Rep. Hughes) (discussing the Copyright Reform Act of 1993). Representative Hughes is the Chairman of the Subcommittee on Intellectual Property and Judicial Administration and Senator DeConcini is the Chairman of the Subcommittee on Patents. *Id.* See also 139 CONG. REC. S1617-01 (1993) (statement of Sen. Deconcini) (discussing the Copyright Reform Act of 1993).

118. 139 CONG. REC. E338 (1993) (statement of Rep. Hughes). The Copyright Reform Act of 1993 proposed to reverse *Peregrine* and *AEG* to the extent that the decisions held that §§ 205 and 301 of the Copyright Act preempt Article 9 U.C.C. statutes for perfecting security interests. May, *supra* note 4, at 509 (citing 139 CONG. REC. S1618). "It changes § 301(b) of the Copyright Act to state, 'Nothing in this title [17 U.S.C.A. §101 et seq.] annuls or limits any rights or remedies under the common law or statutes of any state with respect to . . . perfecting security interests.'" *Id.* Representative Hughes stated that "Congress' intent in enacting the relevant provisions in § 205 was to provide a system for ordering the priority between conflicting transfers, not to preempt state procedures for ensuring that a secured creditor's rights are protected. There is no reason why the Federal and State systems cannot coexist in this area." 139 CONG. REC. E338 (1993).

Other proposals have been made in attempting to create a suitable method for perfecting a security interest in a copyright. As a result of the on-going confusion regarding the perfection and priority of security interest in copyrights, the business law of the American Bar Association established the Task Force on Security Interests in Intellectual Property. May, *supra* note 4, at 536 (citing the Preliminary Report of the ABA Task Force on Security Interests in Intellectual Property (Business Law Section), American Bar Association Working Doc. No. M6-51 (1992)). The Task Force advocated a "mixed approach" in which parties would "file at both the state and federal level in order to be protected." *Id.* at 537. Ad Hoc Committee on Security Interests, Resolution 408-1, at 419 (1988). Under this approach,

1. *A Constitutional Mandate*<sup>119</sup>

A federal system is the best and only recognized way to perfect a security interest in copyrights.<sup>120</sup> Article I, section 8, clause 8 of the U.S. Constitution states that "The Congress shall have Power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . ." <sup>121</sup> In applying its power, Congress continually seeks to introduce laws that encourage and promote the "progress of science and useful arts."<sup>122</sup> At present, the policy reasoning behind copyright protection is to "encourage the production and dissemination of works of authorship."<sup>123</sup>

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"the creditor would file according to the U.C.C. and priority be controlled by the U.C.C.," as well. *Id.* at 538. "At a minimum, this method would create conflicting priority matters, and it could possibly dispose of the authority of 205 of the Copyright Act." *Id.*

The Article 9 Committee also recognized that uncertainty exists regarding the perfection security interest in copyrights. Baldwin, *supra* note 1, at 1724. The committee supports using two federal filing recording systems. *Id.* The committee believes that the "federal notice filing system should be indexed according to the name of the debtor, and should permit the filing of a single document to cover and perfect security interests in after-acquired, federally regulated property and proceeds arising out of that property." *Id.* (citing PERMANENT EDITORIAL BD. FOR THE UNIFORM COMMERCIAL CODE, REPORT OF THE ARTICLE 9 STUDY COMMITTEE 50-55, 55 (1992) (hereinafter "Article 9 Report"). The Committee urges that perfection of security interests be accomplished only through a U.C.C. filing, but it recommends that "Article 9 and federal law should be revised to provide that a security interest can be perfected . . . either in accordance with Article 9 or by recordation in the appropriate federal tract index." *Id.* at 1725 (citing Article 9 Report at 51). Recording under the federal notice-filing system would not be required or sufficient to perfect a security interest. *Id.* (citing Article 9 Report at 51). "The Article 9 Committee also believes that the lender should be allowed to file a single document," effecting a lien on "all of a debtor's after-acquired property and proceeds if agreed upon by the parties." *Id.* at 1726.

119. Baldwin, *supra* note 1, at 1728.

120. See *Peregrine*, 116 B.R. at 203.

121. U.S. CONST. art. I, § 8, cl. 8.

122. *Id.*

123. Baldwin, *supra* note 1, at 1728 (citing Peter Jaszi, *Toward a Theory of Copyright: The Metamorphoses of "Authorship,"* 1991 DUKE L.J. 455, 459 (noting the modern purpose of copyright law)). Baldwin provides an explanation of early copyright law in an endnote: Early copyright law often incorporated the notion that the main purpose of copyright law was to reward the author for conceptualizing and producing a superior work of art. In *Burrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53 (1884), the Supreme Court reflected this approach by extending copyright to photographs for the first time. In finding that the photographer was an "author" for purposes of copyright law, the Court felt it was important that the photograph was a "useful, new harmonious, characteristic, and graceful picture, and that the plaintiff made the [photograph] . . . entirely from his own original mental conception, to which he gave visible form." *Burrow-Giles Lithographic*, 111 U.S. at 60 (quoting the trial court). Baldwin, *supra* note 1, at 1738 n.134. Baldwin further explains modern copyright law: Modern copyright law no longer utilizes this approach. This position was recently promoted by the Supreme Court in *Feist Publications, Inc. v. Rural Tel. Serv.*, 499 U.S. 340, 249 (1991), in which the Court noted that the "primary objective of

In turn, identical considerations inducing Congress to legislate copyright protection are involved the creation of a system to regulate security interests in copyrights.<sup>124</sup> A strong federal interest exists in promoting a predictable and accessible registration system that continues to promote the growth, advancement, and use of intellectual property.<sup>125</sup>

Today, in such a technically complex and diverse economy, a company must often offer intellectual property as security in obtaining financing to enable the use of that intellectual property.<sup>126</sup> Without a practical way to secure these interests, lenders may be unwilling to risk issuing loans, thus inhibiting the free flow of commerce. A strong federal interest exists in ensuring that such financing is available.<sup>127</sup> The very purposes for which Congress protects and encourages copyrighting material would be inhibited if a the system for perfection remains unclear. Technological advancement would never reach its full potential.

## 2. *Peregrine Reasoning*

Perhaps the most poignant reasoning supporting a federal registration scheme is discussed in *In re Peregrine Entertainment*.<sup>128</sup> As held by the *Peregrine* court, Article 9 of the U.C.C. does not apply to perfection of security interests for which an adequate federal filing system exists.<sup>129</sup>

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copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.'" This conclusion demonstrates the modern approach that the purpose of copyright law is to "encourage dissemination of valuable works." Baldwin, *supra* note 1, at 1738 n.134.

124. Baldwin, *supra* note 1, at 1729.

125. See *supra* note 123 (discussing the promotion of science and useful arts). The Copyright Act was enacted to provide the Copyright Office with authority to control the filing and maintenance of copyrights. Citizens should be able to look to the Copyright Office and its federal system for perfecting security interests in copyrights. If citizens cannot rely on the Copyright Office, it may create an inherent uncertainty in all aspects of federal dealings.

126. Baldwin, *supra* note 1, at 1730.

127. "The value of intellectual property has increased dramatically in recent years, to the point where, in many instances, a company's intellectual property is now far more valuable than its real property." Baldwin, *supra* note 1, at 1704.

128. *Peregrine*, 116 B.R. at 199. "[T]he comprehensive scope of the federal Copyright Act's recording provisions, along with the unique federal interests they implicate, support the view that federal law preempts state methods of perfecting security interests in copyrights . . . ." *Id.*

The court cited a United States Supreme Court decision *Community for Creative Non-Violence v. Reid*, 109 S. Ct. 2166, 2177 (1989), stating that "The federal copyright laws ensure 'predictability and certainty of copyright ownership,' 'promote national uniformity' and 'avoid the practical difficulties of determining and enforcing an author's rights under the differing laws and in the separate courts of the various States.'" *Id.* at 199

129. *Peregrine*, 116 B.R. at 194. See THE LAW AND BUSINESS OF COMPUTER SOFTWARE, *supra* note 64, § 27.06[b][1]. Section 9-302 cmt. 8 cites the Copyright Act as being sufficiently detailed to preempt Article 9. U.C.C. § 9-302 cmt. 8 (1996).

Article 9, section 9-302 reaffirms this idea.<sup>130</sup>

Policy issues influencing the court's decision to support registration in the Copyright Office include the following: (1) a copyright's "lack of an identifiable situs;"<sup>131</sup> (2) preference for a uniform system of prioritizing claims;<sup>132</sup> and (3) a national system for recording security interests in copyrights gives nationwide, constructive notice to third parties of the recorded encumbrance.<sup>133</sup> These policy reasons, along with the "voluntary step back" provision<sup>134</sup> of Article 9 of the U.C.C. (which allows federal regulation to preempt the state governed U.C.C.), allows for the conclusion that perfection of security interests in computer software copyrights can and should be accomplished through filing in the U.S. Copyright Office.

#### B. THE STEPS TO TAKE IN PERFECTING A SECURITY INTEREST IN A SOFTWARE COPYRIGHT

Not only may a lender be discouraged by the confusion and discrepancies between the Copyright Act and the U.C.C., but the lender may be deterred by the various steps that must be taken when filing and perfecting an interest through the Copyright Office. This section sets forth steps to take in perfecting a security interest in computer software copyrights.

First, a lender should obtain a detailed listing of the exact software in which the lender will secure an interest.<sup>135</sup> Intellectual property is often difficult to understand. Unlike real property, it is decidedly intangible.<sup>136</sup> When examining the property to be obtained, the lender must

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130. U.C.C. § 9-302 (1996).

131. *Peregrine*, 116 B.R. at 201. Intellectual property such as copyrights, trademarks, and patents is fundamentally different from tangible property, which exists at some physical location. *Id.* "[The] lack of an identifiable situs militates against individual state filings and in favor of a single, national registration scheme." *Id.*

132. *Id.* at 202.

133. *Id.* The court states that, "a recordation scheme best serves its purpose where interested parties can obtain notice of all encumbrances by referring to a single, precisely defined recordation system." *Id.* at 201. The court goes on to note that given the "virtual absence of dual recordation schemes in our legal system, Congress cannot be presumed to have contemplated such a result." *Id.* The court thus concluded that any state recordation system pertaining to interests in copyrights would be preempted by the Copyright Act. *Id.* at 201-02.

134. *See* U.C.C. § 9-104(a). "Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statutes and excluded from this Article." U.C.C. § 9-104(a) cmt. 1. For further discussion of the U.C.C. fall-back provisions, *see generally* BAIRD & JACKSON, *supra* note 3, at 153 (discussing exclusions from the U.C.C. based on federal statutes).

135. Interview with Paul F. Stack, Esq., Stack & Filpi Chtd., in Chicago, Ill. (Oct. 1, 1996) [hereinafter "Stack"].

136. *Id.*

verify that the computer program indicated is indeed the same program as represented by the borrower.<sup>137</sup>

Ideally, the company that the lender is doing business with will supply the lender with the "source code"<sup>138</sup> of the computer program.<sup>139</sup> Upon receipt of the source code, the lender should hire a technician to translate the code into understandable terms and then compare the translation to the initial representation made by the borrowing company.<sup>140</sup> The lender should place the translation and the borrower's provided copy in a vault or with a professional escrow service for safekeeping.<sup>141</sup>

To compare the copy received from the borrower with the copy on file with the Copyright Office, the lender must make a request for a certified copy of the deposit from the Copyright Office. To do this, the lender should obtain the title of the computer program, the author's name, the year the program was created, the copyright registration number of the computer program, and any other identifying information.<sup>142</sup> The lender should ask the Copyright Office to review the request and quote a fee for providing a copy of the deposit.<sup>143</sup>

If the deposit merely consists of "identifying portions,"<sup>144</sup> in which

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137. *Id.* If a lender does not carefully look over each item listed, the lender could easily be deprived of essential programs or copyrights. *Id.*

138. *Sega Enter. Ltd. v. Accolade, Inc.*, 977 F.2d 1510, 1514 n.2 (9th Cir. 1992) (explaining that "computer programs are written in specialized alphanumeric languages, or "source code"). "In order to operate a computer program, an engineer must translate the source code into computer readable form or 'object code.'" *Id.* "Object code uses only two symbols, 0 and 1, in combinations which represent the alphanumeric characters of the source code." *Id.*

139. U.C.C. § 9-104(a).

140. *Id.*

141. *Id.* "When an investor wishes to make certain that the intellectual property of a borrowing company is available for salvage if the company fails, the parties may use an escrow arrangement." L.J. KUTTEN, *COMPUTER SOFTWARE: PROTECTION, LIABILITY, LAWS, FORMS* § 27.10(c)(4) (1991).

142. These key pieces of information are needed in order for the Copyright Office to locate the requested deposit. Copyright Office Telephone Information Line at (202) 707-3000 (Oct. 18, 1996) [hereinafter Copyright Information Line]. To obtain a copy of the materials deposited with the Copyright Office, the lender must provide written authorization from the copyright claimant of record, the claimant's designated agent, or from the owner of any of the exclusive rights in the copyright so long as this ownership can be demonstrated by written documentation. JAMES E. HAWES, *COPYRIGHT REGISTRATION PRACTICE* §§ 31.03, 31-6 to 31-7 (1990 & Supp. 1995).

143. HAWES, *supra* note 142, § 31-7.

144. See HAWES, *supra* note 142, at §§ 19.06, 19-19. "[I]dentifying portions means either the first and last twenty-five pages of a printout of the work, or equivalent units of work if reproduced in some other fashion, together with the page or equivalent unit containing copyright notice, if any." *Id.* See 1 *COMPUTER PROTECTION SOFTWARE LAW*, §§ 208.2(g)(6), 208-28 (Carey H. Sherman et al. eds., 1989 & 1991 Supp.). There have been

only portions of the computer program appear, the lender must obtain a printout of the program from the borrower in hard copy form.<sup>145</sup> The lender must then compare the hard copy to the portions available through the Copyright Office to verify that the program represented to the lender is, in actuality, the program that is on file in the Copyright Office.<sup>146</sup>

While perfecting a security interest in a copyright, the lender should request the Copyright Office to perform a search, confirming that no other security interests are perfected in the copyright in question.<sup>147</sup> Additionally, a prudent lender should also perform a U.C.C. search, at minimum, for the state in which the company has its principle place of business and in the state in which the company is incorporated in order to determine if the copyright is potentially encumbered.<sup>148</sup> Although a security interest in a copyright is not deemed perfected through a U.C.C. filing alone, the search may uncover potential problems and complexities when perfecting an interest through the Copyright Office.<sup>149</sup> In addition, the lender should require that the borrower provide an affidavit

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repeated efforts by the software industry to extend "secure deposit" treatment to computer software deposits, based upon the fact that trade secret protection for confidential material contained in the software may be lost when copies or identifying portions of the software are deposited with the Copyright Office. *Id.* "Under the deposit regulations for secure tests, the Copyright Office returns the deposited copy to the owner immediately after examining it, provided that "sufficient portions, descriptions, or the like are retained so as to constitute a sufficient archival record of the deposit." *Id.* "In 1978, the Copyright Office rejected a request for secure deposit treatment of software in general, stating that "requests for such special treatment should most properly be handled by applications for special relief." *Id.* (quoting 43 Fed. Reg. 765 (1978)). The Copyright Office has continually denied requests for secure deposit treatment of particular programs, although it has significantly liberalized its program deposit requirements as to enable applicants to withhold any trade secret material." *Id.*

145. Stack, *supra* note 135.

146. Stack, *supra* note 135.

147. Stack, *supra* note 135. Searches for prior encumbrances on a copyright are performed in the Copyright Office by the title or registration of the copyright, rather than by debtor name. 17 U.S.C.A. § 205(c)(1). "Unless otherwise requested, Copyright Office searches include records pertaining to registrations, renewals, assignments and other recorded documents concerning copyright ownership." HAWES, *supra* note 142, at §§ 31.06(4), 31-11. A search takes between eight to twelve weeks of time to complete. Copyright Information Line, *supra* note 142, at 202. The request must be in writing, specify the author of the work, the owner of the copyright, and the title of the work to be searched. Copyright Information Line, *supra* note 142, at 202. The Copyright Office staff will search records at the statutory rate of \$10.00 for each hour or fraction thereof. See Hawes, *supra* note 142, at §§ 31.06(4), 31-10. The lender should provide the estimated amount of the fee with the search request. See Hawes *supra* note 142, at § 31.06(4). The Office will then conduct the search and send a written report, or, if the lender prefers, an oral report by telephone. See Hawes, *supra* note 142, at § 31.06(4).

148. Stack, *supra* note 135.

149. Stack, *supra* note 135.

stating that the intellectual property is unencumbered.<sup>150</sup>

After completing the above steps, the lender should request a "Document Cover Sheet" from the Copyright Office in order to record its security interest.<sup>151</sup> The lender should then file a "Memorandum of Security Interest and Lien on Title" should then be filed<sup>152</sup> along with the "Document Cover Sheet."<sup>153</sup>

Unfortunately, because federal legislation has not yet clarified the proper method for perfecting a security interest in copyrights, the lender is best safeguarded by using a "belt and suspenders" approach, filing both under the appropriate provisions of the U.C.C.<sup>154</sup> and with the Copyright Office.<sup>155</sup>

### C. DISADVANTAGES OF AN ENTIRELY FEDERAL SYSTEM

#### 1. *Subsequently Modified or Developed Property*

Parties to a secured transaction often intend to have their agreement cover related after-developed or modified property as well as the initial copyright.<sup>156</sup> While the U.C.C. simplifies such agreements by providing that a creditor may retain a "continuously perfected security interest if the interest in the original collateral was perfected,"<sup>157</sup> the Copyright Act does not allow for such a blanket lien. If specified in the security

150. Stack, *supra* note 135.

151. Copyright Information Line, *supra* note 142. A "Document Cover Sheet" may be obtained by calling the Copyright Office Forms Hotline at (202) 707-9100.

152. THE LAW AND BUSINESS OF COMPUTER SOFTWARE, *supra* note 64, § 20.18(b), at 20-76.

153. The Copyright Office charges a \$20.00 fee to record a transfer document covering one to ten titles. STEPHEN FISHMAN, THE COPYRIGHT HANDBOOK 9/20 (3d ed. 1996). For additional titles, there is an additional charge of \$10.00 for each group up to ten titles. *Id.* The original document, the signed "Document Cover Sheet," a copy of the "Document Cover Sheet," the recordation fee payable to Register of Copyrights, and the document to be recorded should be sent to:

Documents Unit, LM-462  
Cataloging Division  
Copyright Office  
Library of Congress  
Washington, D.C. 20559

*Id.* at 9/22. Within six to eight weeks, a "Certificate of Recordation" should be received from the Copyright Office along with the original document. *Id.*

154. U.C.C. § 9-101 (1996). Form U.C.C.-1 should be filed with the Secretary of State in the state in which the borrower has its principle place of business, listing as collateral the program, its copyrights, and its tangible embodiments (source code and design documentation) as well as any licenses that may be involved in the deal. See THE LAW AND BUSINESS OF COMPUTER SOFTWARE, *supra* note 142, at § 20.18(b), 20-76 (stating a recommended approach to perfecting software security interests).

155. 17 U.S.C.A. § 205 (West 1996).

156. Baldwin, *supra* note 1, at 1710.

157. Baldwin, *supra* note 1, at 1710 (quoting U.C.C. § 9-306(2)). § 9-306(2) provides:



agreement, the filing under the U.C.C. would allow a lender to create a security interest in any after-acquired or after-developed intellectual property.<sup>158</sup> However, because a security interest in copyrights cannot be perfected through a U.C.C. filing alone,<sup>159</sup> lenders must address inherent problems in the current federal filing system.

Under the current federal system, lenders are apparently unable to establish a blanket lien allowing for a U.C.C.-like automatic perfection of after-developed property.<sup>160</sup> For every new derivative copyright, the lender must file a new security interest agreement.<sup>161</sup> For example, if the borrower modifies the original copyrighted computer program and registers this derivative work with the Copyright Office, the lender must file an entirely new security interest in the work to maintain a perfected security interest. The lender may find itself "empty-handed" if the borrower does not inform the creditor of any new changes or modifications to the computer program which give rise to a new copyright.<sup>162</sup> Even if the lender files against the new copyright, "the uncertainty of perfection is not resolved because a bankruptcy court might void the lender's per-

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Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

U.C.C. § 9-306(2) (1996).

158. Baldwin, *supra* note 1, at 1710.

159. See Peregrine, 116 B.R. 194 (holding that in order to perfect a security interest in a copyright, the interest must be filed with the United States Copyright Office).

160. Baldwin, *supra* note 1, at 1716.

161. In order to file a security interest under the Copyright Act, a document that "specifically identifies the work to which [such document] pertains" requires appropriate filing. 17 U.S.C. § 205(c)(1).

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 —

- (1) 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
- (2) registration has been made for the work.

*Id.*

162. Baldwin, *supra* note 1, at 1717. "Although a persuasive argument can be made that the Copyright Act preempts state law on the perfection of security interests, based on §§ 201(d)(1), 204(a), 205(c), and 205(d) of the Revised Act, that the Revised Act preempts state law on perfection of security interests, the Revised Act's failure to provide constructive notice of interests in unregistered works (such as computer programs to be written in the future) suggest that the Act might not provide the adequate system of filing required by the U.C.C. for such preemption." See *THE LAW AND BUSINESS OF COMPUTER SOFTWARE* § 27.06[b][1] (citing 17 U.S.C. § 30).

fectured security interest as a preference.”<sup>163</sup>

Thus, the lender is exposed to substantial risk, as it may lose its security in the copyright and could be treated as a general, unsecured creditor. A practical way of avoiding such danger is to require a warranty and a notice system on part of the borrower. A lender may incorporate special provisions in legal documents and contracts to avoid such pitfalls.<sup>164</sup>

## 2. Priority

Another problem particular to a federal filing system is the provision for priority among conflicting interests.<sup>165</sup> The U.C.C. contains a “first-to-file rule,”<sup>166</sup> while the Copyright Act contains a “relate-back period,” allowing only a one-month period to register transfers executed in the United States.<sup>167</sup> This priority rule does not affect the perfection of an assignment, but it may reduce lender confidence in the results of

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163. Baldwin, *supra* note 1, at 1717 (citing DOUGLAS G. BAIRD & THOMAS H. JACKSON, SECURITY INTERESTS IN PERSONAL PROPERTY 66-67 (2d ed. 1987)). “A preference is simply a transfer made by the debtor on the eve of bankruptcy that favors one creditor over another.” *Id.* Generally, any transfer made by the debtor within 90 days of bankruptcy is subject to preference scrutiny, and thus subject to possible avoidance. See 11 U.S.C.A. § 547 (West 1996).

164. Stack, *supra* note 135. The lender might provide that the borrower would be subject to fines or penalties if notice of new copyrights is not given. Of course, this would not eliminate all elements of risk in the case of the borrower’s bankruptcy.

165. Baldwin, *supra* note 1, at 1718.

166. See U.C.C. § 9-312(5) (1996). This section provides the following:

[P]riority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

*Id.*

See also U.C.C. § 9-312 cmt. 1. “In a variety of situations two or more people may claim an interest in the same property. The several situations specified in subsection (1) contain rules for determining priorities between security interests.” *Id.*

167. See 17 U.S.C.A. § 205(d) (West 1996). This section states the following:

Priority Between Conflicting Transfers: As between two conflicting transfers, the one executed first prevails if it is recorded, in the 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.

*Id.*

searches concerning the ownership of the intellectual property.<sup>168</sup>

A great need exists for legislators to address and resolve these problems confronting lenders and borrowers alike when perfecting a security interest through the Copyright Office. Until that time comes, given the current trend in case law, lenders are unfortunately left with no choice but to take all appropriate precautions and move forward both with a filing in the Copyright Office and under Article 9 of the U.C.C.

#### D. RECENT CASE LAW: FOLLOWING THE *Peregrine* Approach

Recent case law suggests that courts support the *Peregrine* approach. As recently as July 31, 1996, a New York appellate court supported the *Peregrine* decision.<sup>169</sup> The New York Supreme Court stated that it did not question the *Peregrine* court's holding.<sup>170</sup> That court agreed that in order to perfect a security interest in a copyright, the secured party must record the copyright with the federal Copyright Office;<sup>171</sup> thus, a filing under the U.C.C. is insufficient.<sup>172</sup>

At present, no negative case law exists, to impact the California court's *Peregrine* decision.<sup>173</sup> Although unenacted legislation,<sup>174</sup> such as the Copyright Reform Act of 1993, indicates legislative concern with the process of perfecting a security interest under the Copyright Act, courts are not hesitating to opt for a federal system of perfecting security interests in copyrights, thereby upholding the integrity of the very foundation of federal interest in copyright law.<sup>175</sup> Therefore, the legislature should follow the movement of the courts and specifically set forth a clear federal filing scheme under the Copyright Act.

### IV. CONCLUSION

There is clearly a strong federal interest in ensuring that financing for intellectual property is freely available. Without the support of finan-

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168. Baldwin, *supra* note 1, at 1718.

169. MCEG Sterling, Inc. v. Nizer, 646 N.Y.S.2d 778 (1996).

170. *Id.*

171. *Id.*

172. *Id.* In *MCEG Sterling v. Nizer*, the Court decided a legal malpractice case, where Sterling sued Nizer on a claim of legal malpractice for the alleged failure to properly secure a security interest in the collateral for a loan. *Id.* In dismissing the complaint, the court held that the defendant attorney was not required to employ a "belt and suspenders" approach to perfecting a security interest by filing both with the Copyright Office and under the U.C.C. *Id.* at 3-4. Filing with the Copyright Office, as in *Peregrine*, would have been enough. *Id.*

173. At the time of writing, Shepardizing the *Peregrine* case has presented no negative authority.

174. See *supra* note 117 and 118 (discussing the proposed Copyright Reform Act of 1993).

175. See U.S. CONST. art. I, § 8, cl. 8.

cial lenders, development of intellectual property slows. The goals of intellectual property are to promote the continuing progress of science and the useful arts.<sup>176</sup> Without financial support from lenders, giant companies with sufficient funds will control the market. There would be no room for healthy competition.

Certainly, clarification and new legislation is needed to simplify the process of perfecting a security interest in copyrights.<sup>177</sup> Until that time, leading decisions such as *Peregrine* indicate that lenders must first and foremost file their interests with the Copyright Office. Without such a filing, a security interest is sure to remain unperfected. A national filing system will create a uniform system, thus reassuring lenders and lessening their financial risk. Only one filing would need to occur, thus eliminating the time and expense of dual filing. Only the Copyright Office would need to be searched to discover previously existing interests. A national system can only benefit the nation as a whole in keeping the United States at the forefront of the technological race.

*Aimee A. Watterberg*

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176. *Id.*

177. The proposed Copyright Reform Act of 1993, the ABA Task Force proposal, and the Article 9 Committee proposal attempted to find solutions to the apparent contradictions of the U.C.C. See generally *supra* note 118. (explaining how each of these proposals remain confusing and, until such all-encompassing legislation is passed, none of these proposals help direct lenders to perfect security interests in copyrights).

