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Software Copyrights as Loan Collateral: Evaluating the Reform Proposals

by

PATRICK R. BARRY*

Introduction

Software has become a major force in the world economy.¹ Not only are the revenues generated by the production and sale of software significant,² but software also plays critical roles in the development of technology³ and in the organization of institutions from small businesses to vast governmental bureaucracies.⁴ These roles will likely expand as our society becomes increasingly reliant on information as a commodity. As the role of software in society expands and changes, the law must keep pace.⁵

This Note explains how recent court decisions expanding the application of federal copyright law have rendered obsolete the current...
regime for the perfection\textsuperscript{6} of security interests in copyrights. It then examines some current reform proposals and identifies which aspects of those proposals would help software companies\textsuperscript{7} produce important new products by facilitating the use of copyrights as loan collateral.

The software industry's continued commercial vitality depends in large part upon the various bodies of law that affect the creation, protection, and use of software products. One important use of copyrights underlying software products is as collateral in loan transactions. The two most important legal regimes bearing upon the use of copyrights to secure debts are the Copyright Act of 1976\textsuperscript{8} and the Uniform Commercial Code. Taken together, these two statutes govern both the substantive and the transactional issues arising in conjunction with the use of copyrights as collateral, though each has its particular focus and characteristics.

The Copyright Act plays a critical role in the development of new software products by conferring substantive rights of exclusivity and control over the copyrighted material.\textsuperscript{9} These rights are important to software developers because while software products may require years of development, they are highly susceptible to quick and inexpensive duplication. The Framers of the U.S. Constitution perceived the value of encouraging innovation and the development of new ideas and made express provision for the preservation of authors' and inventors' exclusive rights in their works.\textsuperscript{10} Through the Copyright Act, Congress has fostered software creativity by protecting the efforts of developers from unauthorized copying and exploitation.\textsuperscript{11}

\textsuperscript{6} If a security interest is perfected, it is senior in priority to most subsequent interests of other creditors. See Douglas J. Whaley, Problems and Materials on Secured Transactions (3d ed. 1993).

\textsuperscript{7} "Software companies" or "software developers" refer to the myriad of companies that produce computer software or hold significant copyrights to computer software. Computer software can take many forms, including, but not limited to, operating systems "burned into" read-only memory (ROM) chips; databases, which may be embedded in computer programs; and application programs. G. Larry Engel & Mark F. Radcliffe, Intellectual Property Financing for High-Technology Companies, 19 UCC L.J. 3, 28 (1986).


\textsuperscript{9} The Copyright Act gives a copyright holder a number of exclusive rights including the right to enjoy the revenues generated by the copyrighted work and the power to exclude others from doing so. 17 U.S.C. § 106 (1988). Thus, the Copyright Act confers a limited monopoly and rewards the author's intellectual effort. Clapes, supra note 1, at 162.

\textsuperscript{10} "The Congress shall have the power . . . 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." U.S. Const. art. I, § 8, cl. 8.

\textsuperscript{11} "[S]oftware is now firmly embedded within the Copyright Act's protection of literary works." Carroll, supra note 3, at 1329. The Copyright Act defines a "computer program" as "a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result." 17 U.S.C. § 101 (1988). "Literary works" are
Copyrights have emerged as the preferred form of intellectual property protection for software companies in the United States\textsuperscript{12} and, as such, are the most prominent form of intellectual property held by such companies.\textsuperscript{13}

Article 9 of the U.C.C., the touchstone of state commercial finance law, is also critical to the software industry's continued success. The procedural and substantive dictates of Article 9 shape the way in which lenders perceive and value one of a developer's most significant assets—its intellectual property.\textsuperscript{14} This, in turn, has a ripple effect upon incentives for creativity. The basic argument runs as follows: If commercial finance law imposes inordinate costs and risks upon lenders in conjunction with the use of intellectual property as collateral, then lenders will be less likely to extend credit to companies with a large proportion of their assets in this form.\textsuperscript{15} Therefore, finance laws that are uncertain or unclear or that impose procedural burdens on the use of intellectual property as collateral reduce the value of such

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12. \textsc{Natl Research Council}, \textit{supra} note 2, at 22.


Software developers have long relied on state trade secret laws to protect secret aspects of their programs. \textsc{Natl Research Council}, \textit{supra} note 2, at 29-30. Trade secret law is entirely a matter of state law; no federal statutes apply to such security interests. Robert S. Bramson, \textit{Intellectual Property as Collateral—Patents, Trade Secrets, Trademarks and Copyrights}, 36 \textit{Bus. Law.} 1567, 1583 n.82 (1981). Material protected by state trade secret law may mature into copyrightable matter when it becomes "fixed in a tangible medium of expression." \textit{See} 17 \textsc{U.S.C.} §§ 101, 102 (1988). Upon the material becoming "fixed," any protection it had under state law is preempted by the Copyright Act. \textit{See} 17 \textsc{U.S.C.} § 301 (1988). This fact takes on some significance given recent precedent holding that security interests in unregistered copyrights are unperfected. \textit{See infra} text accompanying notes 91-94. However, a complete discussion of patents and trade secrets is beyond the scope of this Note.


property by preventing its use to secure loans. This, in turn, reduces market incentives for the creation of new software and hinders entrepreneurial efforts by reducing the universe of potential collateral available to such companies.

Loan transactions involving software companies are particularly affected by the interlocking structures of copyright and commercial finance law. The software industry has seen rapid growth in recent years, spurred at least in part by the relatively low capital requirements for participation in the market. Because software developers can produce a product largely from individual effort with only minimal capital input, it is not unusual for a program written by an individual or a small group to become a major force in the software market. When this occurs, the young firm's principal assets are intangible, including its intellectual property rights and any contract rights it may have obtained. The firm's other property, such as its equipment and fixtures, is usually of little value given the industry's low capital requirements. Therefore, intellectual property is often the only valuable asset of many firms in the software industry.

When a start-up software company wishes to finance large-scale production, marketing, and distribution of its product or when a more established software vendor desires to make operational changes requiring an infusion of capital, copyrights and related receivables may be used as collateral for a bank loan. As discussed, copyrights loom large in such financings, particularly because the firm's other (tangi-

17. See Nimmer & Krauthaus, supra note 14, at 195-202 (discussing how software companies and other holders of information assets are affected by the interrelationship between copyright and commercial finance law).
18. "Market statistics vary, but they suggest that over the past 25 years the number of U.S. software firms has quadrupled, and the size of the product market has been doubling about every five years." Nat'L Research Council, supra note 2, at 3.
19. Clapes, supra note 1, at 22.
20. Market entry costs have increased somewhat in recent years, given the demands of an expanding market. Negotiating compatibility with other products, testing, and customer support are all areas requiring capital outlay. Nat'L Research Council, supra note 2, at ix.
21. Clapes, supra note 1, at 22.
22. Contract rights and intellectual property rights, including the right to receive payment under a copyright license agreement, are both "general intangibles" under the U.C.C. See U.C.C. §§ 9-106, 9-106:1, 9-106:8, & 9-106:9 (1990). Here the word "intangible" is used only to indicate the incorporeal nature of start-up software company assets and not as a statement of U.C.C. Article 9 applicability.
23. See Engel & Radcliffe, supra note 7, at 3.
24. See supra note 19.
25. This Note uses the phrase "copyright-related receivables" or "related receivables" to denote rights to be paid that accrue to the holder or licensee of a copyright through that party's exploitation of the copyright, whether by license agreement or by some other means.
ble) assets tend to have little value. Because the nexus between federal copyright law and state finance law imposes greater lender risk, cost, or uncertainty than in a standard tangible property financing, the value of the property as security is diminished. Accordingly, the software company has a smaller pool of assets available to entice resource providers than it would if the law did not discriminate among types of collateral. Thus, the law governing use of copyrights as collateral hinders the company's ability to leverage itself and to bring a useful product to market.

At present, software developers face an uncertain nexus between copyright law and finance law. This state of affairs has prompted commentators, business people, and politicians alike to call for changes in the law to encourage creativity and investment in software development. Part I of this Note describes the legal foundation for the current state of the law, explicates a case that has resolved some of the uncertainty plaguing this area for years, and discusses some of the legal and logistical fallout from this decision. Part II discusses a number of recent reform proposals advocated by the American Bar Association Task Force on Security Interests in Intellectual Property, the Permanent Editorial Board Article 9 Study Group, and recent legislation introduced into Congress. Part III evaluates the effect these proposals would have on software companies and suggests an appropriate resolution of the current debate.

I. Background

A. Uncertainty in the Field

In the past, the relationship between the Copyright Act and the U.C.C. has been unclear. Ambiguity in the U.C.C. coupled with a lack of guidance from the Copyright Act and the courts left practitioners uncertain whether state or federal law controlled perfection of security interests in copyrights. When schemes conflict, the resulting uncertainty leads to litigation and "raises the costs of contracting because lawyers attempt to comply with competing regimes rather than..."
risk a faulty transaction. Supra note 15, at 438.

Security interests in copyrights present one such conflict between the U.C.C. and the Copyright Act. See infra notes 36-51.

Although the U.C.C. generally governs formation and perfection of security interests in personal property, copyrights present an exceptional case. The U.C.C. itself is ambiguous concerning whether its perfection provisions cover security interests in copyrights. See generally for a security interest in personal property to become effective against third parties, i.e., to "attach," the lender and the debtor must agree to create the security interest, there must be a signed security agreement or a transfer of possession, and value must be given. U.C.C. § 9-203 (1991).

In most cases a lender can perfect a security interest by filing a financing statement with the relevant state official, usually the Secretary of State, although the U.C.C. provides for alternative means of perfection depending upon the personal property in question. See U.C.C. § 9-302 (1991). The rules surrounding perfection of security interests are important because they "assist in the determination of the priority of rights held by the lender in the collateral against third parties." John L. Mesrobian & Kenneth R. Shaefer, Secured Transactions Based on Intellectual Property, 72 J. PAT. & TRADEMARK OFF. SOC'Y, 827, 831 (1990). Priority most often becomes relevant in determining the rights of creditors in bankruptcy proceedings or when claims are made by third party purchasers of the collateral. See generally Thomas M.S. Hemnes & Susan Barbieri Montgomery, The Bankruptcy Code, the Copyright Act, and Transactions in Computer Software, 7 COMPUTER/L.J. 327 (1987) (discussing the effect of a software producer's bankruptcy on software license and asset purchase transactions). Perfection also serves the practical function of giving notice to interested parties of the existence of a security interest in the property in question. See Peregrine Entertainment, Ltd. v. Capitol Fed. Sav. & Loan Ass'n (In re Peregrine), 116 B.R. 194, 200 (C.D. Cal. 1990).

See, e.g., Bramson, supra note 13, at 1581 (noting that it is unclear whether the Article 9 filing provisions apply to security interests in copyrights).


See U.C.C. § 9-302(1) (1990) (stating the general rule that all but the listed exceptions must be filed to perfect a security interest and failing to list general intangibles); U.C.C. § 9-401 (1990) (stating the proper place for filing).


lists the Copyright Act as just such a statute and states that when "an adequate system of filing, state or federal, has been set up outside this Article . . . perfection of a relevant security interest can be had only through compliance with that system." Although the Official Commentary does not have the force of law, these comments strongly suggest that the drafters intended to remove copyrights from Article 9 coverage. This interpretation seems correct because section 205(a) of the Copyright Act has established a comprehensive method for recording security interests in copyrights with a national registration system and a central filing location (the Copyright Office) different from that established by the U.C.C.

On the other hand, the Official Commentary to section 9-104(a) of the U.C.C. arguably contradicts the Official Commentary to section 9-302. The former states:

Although the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright . . . such a statute would not seem to contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in copyrights from the provisions of this Article.

This Commentary asserts that the Copyright Act as it then existed would not satisfy the "step-back" requirement of section 9-104 and consequently that the U.C.C. does not yield to that federal statute, at least in regards to the perfection of security interests in copyrights. But the plain meaning of the Official Commentary to section 9-302 is that a U.C.C. filing is ineffective to perfect a security interest and that the federal statute controls. The apparent incongruity between these two commentaries renders the text of the U.C.C. ambiguous.

46. When the Commentary was drafted, the Federal Copyright Act of 1909 was the relevant statute, not the modern Copyright Act of 1976. The 1909 Act required only the recordation of "assignments" and did not mention security interests. Federal Copyright Act, Pub. L. No. 60-349, 35 Stat. 1075-88 (1909) (codified as amended at 17 U.S.C. § 30 (1947)). Perhaps this led the drafters to state in the Commentary to U.C.C. § 9-104 that the Federal Copyright Act would not remove perfection of security interests in copyrights from Article 9's coverage. See Bramson, supra note 13, at 1580-81. Whatever the case, the passage of the Copyright Act of 1976 with its well-defined recordation and notice system created a strong argument that the provisions of U.C.C. § 9-302(3)(a) should apply, removing the perfection of security interests in copyrights from the purview of Article 9. Id. But despite the strong case for federal preemption, and absent a definitive answer on the question from the courts, practitioners have continued to make both state and federal filings. See, e.g., id. at 1579 (advising practitioners to make dual filings).
47. One ambiguity is whether the U.C.C. explicitly removes perfection of security interests in copyrights from its coverage, and not whether federal law preempts the U.C.C. Of course, state law cannot control the issue of federal preemption. Rather, the question
The Copyright Act itself is relatively unhelpful regarding the perfection of security interests in copyrights. The Act permits transfer of copyright ownership by "an assignment, mortgage . . . or any other conveyance, alienation or hypothecation." It also allows recordation of any "document pertaining to a copyright" to serve as constructive notice to all third parties of the information contained in the document. However, the Copyright Act does not explicitly refer to security interests, and the above-cited provisions constitute the full extent of the statute's coverage of the issue. Given the complexity and range of subject matter associated with the creation, perfection, and foreclosure of security interests, the Act's coverage is far from comprehensive. One might wonder how such a skeleton framework could preempt the U.C.C.

B. Peregrine

Until the recent Central District of California decision in Peregrine Entertainment, Ltd. v. Capitol Federal Savings and Loan Ass'n (In re Peregrine), commentators and practitioners were uncertain whether the U.C.C. provided a parallel system for recordation of security interests to that contained in federal copyright law. As a result, lawyers traditionally made filings under both systems to ensure

of preemption depends upon whether federal regulation is so pervasive as to indicate that "Congress 'left no room for supplementary state regulation,'" or if "the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." Hillsborough County v. Automated Medical Lab., Inc., 471 U.S. 707, 713 (1985) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)). A second, perhaps more important ambiguity surrounds the extent to which the U.C.C. is preempted by federal law. For example, even if perfection is governed by federal recordation, do the post-default remedies of Article 9 still apply? For a discussion of the uncertain extent of federal preemption and of problems that may result from this uncertainty, see infra text accompanying notes 87-93.

51. The Copyright Act relies on an older financing concept, called the "collateral assignment," to describe the security relationship. A "collateral assignment" is a transfer of title to the secured party accompanied by a "license" back to the debtor of certain rights under that copyright and a contractual understanding that title will be reconveyed to the debtor upon repayment. See Weinberg & Woodward, supra note 15, at 443. The U.C.C. uses the more modern "bundle of rights" concept of title, which describes a security interest as one stick in the bundle of rights held by the debtor. See Nimmer & Krauthaus, supra note 14, at 201-02.
53. See Bramson supra note 13, at 1579; see also Nimmer & Krauthaus, supra note 14, at 196 ("The questions of whether or to what extent federal laws preempt state rules for perfecting a security interest or determining its priority have not been authoritatively resolved.").
that the security interest had been effectively perfected.\textsuperscript{54} \textit{Peregrine} attempted to resolve some of the uncertainty surrounding such trans-
actions by holding that the U.C.C. is preempted by the Copyright Act
and that filing a U.C.C. financing statement with the Secretary of
State is ineffective to perfect a security interest either in a copyright or
in copyright-related receivables.\textsuperscript{55}

\textit{Peregrine} involved the bankruptcy of Peregrine Entertainment, a
company in the business of licensing films. Peregrine's principal assets
were its library of copyrights, distribution rights, and licenses to app-
proximately 145 films, and its accounts receivable arising from the li-
censing of the films. These assets were pledged as collateral to secure
a six million dollar line of credit. The lender filed both the security
agreement and a form U.C.C.-1 financing statement describing the
collateral with relevant state agencies, but did not record its security
interest in the United States Copyright
Office.\textsuperscript{56} Upon filing for bank-
ruptcy, Peregrine brought suit as a Chapter 11 debtor in possession
against the lender, claiming that the lender's security interest in the
film copyrights and in the accounts receivable was unperfected be-
cause the lender failed to register the security interest with the Copy-
right Office.\textsuperscript{57} As debtor in possession, Peregrine claimed a judicial
lien on all assets, including the copyrights and receivables, and the
power to avoid the allegedly unperfected security interest for the ben-
efit of the estate.\textsuperscript{58} The debtor's claims put the question whether the
U.C.C. provides a parallel and equally effective system for the perfec-
tion of security interests in copyrights squarely at issue.\textsuperscript{59}

As a prelude to its preemption analysis, the \textit{Peregrine} court first
considered whether the Copyright Act applied to the particular secu-
rities interests in question. The court held that the security interest, both
in the copyrights themselves and in the accounts receivable generated
by those copyrights, was subject to recordation with the Copyright Of-
fice pursuant to section 205(a) of the Copyright Act.\textsuperscript{60}

The first aspect of this ruling, concerning the copyrights them-
selves, generally comports with the interpretations of commentators
and with the language of the statute.\textsuperscript{61} The second part of this ruling,
which holds that security interests in accounts receivable can only be

\begin{itemize}
\item \textsuperscript{54} See Nimmer & Krauthaus, \textit{supra} note 14, at 196.
\item \textsuperscript{55} 116 B.R. at 203-04.
\item \textsuperscript{56} Id. at 197-98.
\item \textsuperscript{57} Id. at 198.
\item \textsuperscript{58} Id.
\item \textsuperscript{59} Id. at 197.
\item \textsuperscript{60} Id. at 199.
\item \textsuperscript{61} See Mesrobian & Shaefer, \textit{supra} note 37, at 841-42.
\end{itemize}
perfected by recordation with the Copyright Office, is more question-
able and has been criticized by commentators.62

As support for this second part, the court cited the Copyright Of-

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62. E.g., Eloise L. Morgan, Perfecting Security Interests in Copyright-Related Receiv-
ables, 204 N.Y. L.J. 55 (Sept. 18, 1990); Joseph H. Levi, Perfecting Security Interests in
Copyrights, 204 N.Y. L.J. 53 (Sept. 6, 1990).


64. Id.

65. Compendium of Copyright Office Practices II, ¶¶ 1602-1603 (identifying which
documents the Copyright Office will accept for filing) [hereinafter Compendium]. The
Compendium is a manual that the Copyright Office staff uses as a general guide to its
examination of claims to copyright, recordation of documents, and related practices. Policy
Decision, 57 Fed. Reg. 27,074 (June 17, 1992) [hereinafter Policy Decision].


67. Id. at 200.

68. Id.
would reduce the level of certainty that a search had revealed all conflicting interests. The court also pointed out that the U.C.C. method for determining priority conflicts with the Copyright Act, noting that this type of direct interference with the operation of federal law weighs heavily in favor of preemption. Therefore, the court concluded, the Copyright Act preempted Article 9 with regard to the perfection of security interests in copyrights and copyright-related receivables.

The court also analyzed the U.C.C. itself, concluding that, by its own terms, Article 9 does not apply to the security interest at issue. Essentially, the court evaluated the applicability of sections 9-104 and 9-302 and related Official Commentaries much as discussed above and ruled that the U.C.C. “step-back” provision embodied in section 9-104 takes security interests in copyrights and related receivables outside of Article 9’s coverage.

Finally, the court held that because the lender had not perfected its security interest, Peregrine could recover the lender’s interest for the benefit of the bankruptcy estate. Under the “strong arm clause” of 11 U.S.C. § 544(a)(1), which gives the debtor in possession every right and power conferred by state law on a judicial lienholder, Peregrine was able to “trump” the lender’s unperfected security interest in the copyrights and the receivables. In effect, the court held that the lender made a six-million-dollar unsecured loan.

In handing down its ruling, the court seemed to be aware of the commercial implications of requiring security interests in copyrights

69. Id. at 201. See supra note 47 for a discussion of preemption criteria. While the U.C.C. generally confers priority on the party to file first, U.C.C. § 9-312(5)(a) (1990), the Copyright Act has a “look-back” provision that complicates the determination of priority status as among conflicting transfers. Under § 205(d) of the Copyright Act, when two conflicting transfers exist, the transfer executed first has priority if it is recorded pursuant to the § 205(c) constructive notice requirements and within one month (two months, if executed outside of the United States). 17 U.S.C. § 205(d) (1988).

70. Id. at 202-04. This ruling was largely anticipated by commentators. See, e.g., Note, Perfection of Security Interests in Intellectual Property: Federal Statutes Preempt Article 9, 57 GEO. WASH. L. REV. 135, 136-40, 156-58 (1988) (arguing that the Copyright Act of 1976 preempts Article 9).


73. See supra text accompanying notes 41-47.

74. Peregrine, 116 B.R. at 202-03.

75. Id. at 204-08.


and related receivables to be filed with the Copyright Office rather than with the Secretary of State. The court noted that "filing with the Copyright Office can be much less convenient than filing under the U.C.C." and listed some of the procedural differences between the two systems that make the federal filing more burdensome. Ultimately the court concluded that, though more cumbersome, the federal system is not "unworkable" and that congressional action is necessary to implement "more adequate procedures."79

C. Criticism of Peregrine

Many commentators have attacked the court's holding, but have been largely unpersuasive in their attempts to challenge the court's legal reasoning,80 however unappealing the result may be as a matter of policy. The thrust of these attacks seems to be that, aside from permissive recordation of receivables-related documents, the Copyright Act does not speak at all about receivables financing as a substantive matter and the court gives the federal statute too broad an application. Thus, the court's holding stretches copyright law beyond its traditional scope—an act Professor Jerome H. Reichman has said will lead to "unsupportable restraints of trade and a breakdown of the world's intellectual property system."81

Perhaps echoing Professor Reichman's thesis, one critic argued that the court's reasoning "has only a superficial logic" because "if the proper place for recording a security interest turns on the genesis of the receivable, the U.C.C.'s comprehensive structure for perfecting security interests is weakened."82 But this assertion, although probably

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78. Peregrine, 116 B.R. at 203. The court further noted that filing with the Copyright Office can be much less convenient than filing under the U.C.C. This is because U.C.C. filings are indexed by owner, while registration in the Copyright Office is by title or copyright registration number. This means that the recording of a security interest in a film library such as that owned by [Peregrine] will involve dozens, sometimes hundreds, of individual filings. Moreover, as the contents of the film library changes [sic], the lienholder will be required to make a separate filing for each work added to or deleted from the library. By contrast, a U.C.C.-1 filing can provide a continuing, floating lien on assets. Id. at 203 n.10 (citations omitted).

79. Id.

80. For example, one critic claimed that "a right to receive payment in respect of a copyright" is not a "document" at all and thus should not be recordable under § 205. Leve, supra note 62, at 6. This argument is weak because presumably the license agreement creating the right to be paid and the security agreement attaching that right are "documents" in a conventional sense.

81. Nat'l Research Council, supra note 2, at 12.

82. Morgan, supra note 62, at 6. See supra note 37 for a discussion of perfection under the U.C.C. In its comprehensive system, the U.C.C. distinguishes between "accounts," which are rights to be paid "for goods sold or leased or for services rendered," and all other rights to be paid. U.C.C. § 9-106 (1990). Rights to receive payment under
true, does not show the court's legal analysis to be faulty. Rather it points out why, from a policy perspective, the current state of the law is unsatisfactory—because the policy goals of efficiency and simplicity that guide the U.C.C. are undermined and no meaningful federal interests are furthered by federal preemption in the area of receivables.83

The court's ruling is not incorrect merely because it favored a more cumbersome and unwieldy system for perfecting security interests. Rather, the Peregrine court may have been "forced" into its holding because of congressional inaction or oversight in drafting the Copyright Act.84 As it explained, "this is the system Congress has established and the court is not in a position to order more adequate procedures. If the mechanics of filing turn out to pose a serious burden, it can be taken up by Congress."85 Part III of this Note addresses the question of what form congressional action should take.

83. Three principal policies emerge from the language of the copyright clause: (1) "the promotion of learning"; (2) "the preservation of the public domain"; and (3) "the protection of the author." L. Ray Patterson & Stanley W. Lindberg, The Nature of Copyright: A Law of Users' Rights 48-49 (1991). The promotion of learning is the "keystone" policy. See id. at 49-50. The basic concept is that the publishing of a new work contributes to learning by adding to the general body of knowledge available for study. Id. Protection of the public domain—the realm of things and ideas not subject to private ownership—is furthered through a quid pro quo with the author who obtains a limited-in-time exclusive right in exchange for the creation and publication of new ideas. Id. at 50-51. The policy of protecting authors is vindicated by giving authors an exclusive right to publish their words for a limited amount of time. Id. at 51-52. Nowhere do security interests in accounts receivable figure into this scheme of interlocking policies. Furthermore, even if receivables were implicated by federal copyright policy, given the logistical obstacles created by the federal filing regime, see supra notes 100-106 and accompanying text, the current system works against those policies.

84. Two commentators observed that

[i]n light of the court's concern with congressional intent behind the [Copyright Act], the complexity of the interaction issues, and the statutory silence on the preemption issue, the court in Peregrine may have been forced to the decision that federal law broadly preempted state commercial law, whatever may have been the intent of Congress on the issue. . . . Indeed, the most disturbing and controversial aspect of the decision—that federal preemption extended to the security interest in receivables resulting from the copyrights—may have been inevitable as well.

Weinberg & Woodward, supra note 15, at 170 (footnotes omitted).

D. *Peregrine*’s Impact

The decision in *Peregrine* appears to have been accepted largely as an accurate statement of the law.\(^8\) Although *Peregrine* has the positive effect of reducing uncertainty in this area by resolving the preemption question, it creates legal uncertainty regarding the scope of federal preemption. Moreover, it highlights the impracticalities of complying with federal law. Finally, *Peregrine* has sparked legislative, agency, and private initiatives to correct perceived problems in the current regime for perfecting security interests in copyrights.

(1) *Peregrine* and Federal Preemption

One difficulty resulting from *Peregrine* concerns the undefined scope of federal preemption or, conversely, the uncertain extent to which the U.C.C. abdicates control over copyrights and related receivables by its own terms. Federal copyright law speaks neither to the formation of security interests nor to foreclosure issues, both of which have traditionally been left to state law. The principal uncertainty is the extent to which the Copyright Act impinges on these heretofore strictly state law strongholds and the extent to which the U.C.C. fills the gaps.\(^8\) For example, what role does federal law play with regard to rights in a copyright acquired by a transferee upon foreclosure?\(^8\) As discussed below, a copyright must be registered for the federal filing to effectively perfect a security interest.\(^8\) If this is so, does state law control perfection of security interests in unregistered copyrights? These and other issues remain unresolved after *Peregrine*.\(^9\)

(2) Additional Filing Burdens

As a practical matter, the holding in *Peregrine* means that borrowers will potentially have to make a larger number of additional filings than if the U.C.C. provided a parallel perfection system. One reason for this is that the Copyright Act imposes a registration re-

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\(^8\) See, e.g., AEG Acquisition Corp. v. Zenith Productions, Inc. (*In re AEG Acquisition Corp.*), 127 B.R. 34, 40 (1991) (citing *Peregrine* for the rule on perfection of security interests in copyrights). However, it must be emphasized that *Peregrine* represents the view in one district in California and does not have binding authority outside the district. Notwithstanding the decision’s limited jurisdictional reach, its effect on various groups outside the district suggests that its importance may transcend jurisdictional lines.

\(^8\) The Official Commentary to U.C.C. § 9-104 specifies that “if the federal statute contained no relevant provision, this Article could be looked to for an answer.” U.C.C. § 9-104:1 (1990).

\(^8\) P.E.B. REPORT, supra note 29, at 53 (questioning the scope of federal law in the foreclosure context).

\(^8\) See infra notes 92-93.

\(^9\) Another area of potential conflict concerns the differing title concepts employed by each system. See supra note 51.
requirement in addition to the recodarion requirement of section 205. For a recodarion under section 205 to serve as constructive notice to third parties, the copyrighted work must also have been registered with the Copyright Office pursuant to 17 U.S.C. §§ 408, 409, and 410. Therefore, a transferee without notice, such as a bona fide purchaser, will take if the recorded interest or transfer relates to an unregistered copyright. This fact becomes significant in a bankruptcy proceeding when, as the Peregrine court found, a debtor in possession acting pursuant to 11 U.S.C. § 544(a) is deemed to have taken in good faith and without notice. Therefore, lenders will likely require borrowers to register their copyrights to protect against avoidance of security interests in bankruptcy proceedings.

Because works must be registered on an individual basis and recordation must specifically reference the registered work in order to serve as constructive notice, perfection of a security interest in a copyright and related receivables involves a great deal of paperwork. Unlike Article 9, which contemplates filing on a "debtor's name basis," no "blanket" filing is available under the federal system. This means that after-acquired property of the debtor may not be encumbered by a lender without an additional filing. For software vendors, many of whom periodically upgrade their products by producing new versions, these federal registration and specificity requirements man-


92. In fact, this precise issue was decided in AEG Acquisition Corp. v. Zenith Productions, Ltd. (In re AEG Acquisition Corp.), 127 B.R. 34 (1991). There, the debtor was a film library holding copyrights to motion pictures. Id. at 37. The debtor's predecessor gave a creditor rights to three films as security for a loan. Id. at 37-38. The creditor filed in state U.C.C. offices and in the Copyright Office, but did not register all of the films. Id. The court held that the creditor's security interest in the two unregistered films was unperfected. Id. at 41-42.

93. See Peregrine, 116 B.R. at 204-08.

94. To register a work, an applicant must send at least one complete copy of the work (two if published) along with a filing fee to the Register of Copyrights. See 17 U.S.C. § 408 (1988). The Register of Copyrights then determines whether the material submitted constitutes copyrightable subject matter and, if the material is acceptable, issues the applicant a certificate of registration. 17 U.S.C. § 410 (1988). Registration applications can be costly and time-consuming. See Amended Copyright Reform Bill Is Approved by House Subcommittee, 47 PAT. TRADEMARK & COPYRIGHT J. 33 (1993) (describing proposed legislation in the House of Representatives to eliminate copyright registration as a requirement for infringement suits). Additionally, the current backlog in the Copyright Office requires applicants to wait for months before a determination of the suitability of the submission. Telephone Interview with Bill Fralic, Staff Attorney, U.S. Copyright Office (Jan. 1, 1994).

95. 17 U.S.C. § 205(c)(1) provides that a filed document will not provide constructive notice unless it "specifically identifies the work to which it pertains."

date a large number of repetitive, expensive, and burdensome filings.\textsuperscript{97}

Software companies are also adversely impacted because these requirements make it unlikely that copyright-related accounts receivable will be as attractive as traditional collateral to a receivables financier.\textsuperscript{98} This is because receivables arising after the initial filing are not covered without a new filing. Moreover, some companies face the additional expense of paying for the lender's search and filing cost.\textsuperscript{99}

(3) \textit{Uncertain Scope of the Impact}

A further logistical difficulty stems from the \textit{Peregrine} court's implicit holding that a lender must file with the Copyright Office if the borrower's receivables are derived from goods, such as computers or other devices, that contain copyrighted software.\textsuperscript{100} Software has become all-pervasive and now may be found as a material element of overall value in any number of devices from jet engines to video games.\textsuperscript{101} Absent a clear declaration by the court to the contrary, careful lenders will make the federal filing for personal property “containing” valuable software because a failure to do so may leave the lender's security interest in that significant asset unperfected.\textsuperscript{102} If so, the lender, or more likely the borrower, faces all the practical problems associated with identifying and separating the various copyrighted works and their respective owners for filing purposes. Thus, software's pervasiveness coupled with the uncertainty surrounding the law in this area will force the prudent lender to carefully scrutinize property taken as security and to make precautionary filings. Legal uncertainty translates into delay and increased loan costs that will

\textsuperscript{97} \textit{Peregrine} and \textit{AEG} also make it harder to use works in progress as collateral because each time a change is made to a work, that work must be registered in order to qualify as collateral subject to perfection. Weinberg & Woodward, \textit{supra} note 15, at 474-75.

\textsuperscript{98} \textit{Id.} at 474 n.236.

\textsuperscript{99} \textit{Id.}

\textsuperscript{100} See Morgan, \textit{supra} note 62, at 6 (“[P]erfection of security interests in accounts receivable must now be undertaken with an eye to the source from which the accounts spring.”).

\textsuperscript{101} Carroll, \textit{supra} note 3, at 1322.

\textsuperscript{102} The melding of software with noncopyrightable elements also raises a number of important legal questions. For example, must lenders to computer companies make a federal filing to cover the accounts receivable generated by the sale of computers loaded with basic operating system software? If such a filing is required but not made, how is a court to ascribe values to those parts of the goods for which the lender perfected its security interest and to those for which it has not? The court has left lenders and borrowers the somewhat sticky problem of separating out, for filing purposes, the goods from the copyrighted material such goods contain.
likely deter lenders from accepting copyrights and related receivables as collateral.

(4) Impact of Peregrine on Commercial Settings

To put the Peregrine ruling in a business context, consider the example of the retail sale of a software program. Most purchasers of a software program acquire only the diskette and a limited right to use the program it contains. Therefore, the purchaser acquires a "license," not the copyright itself. Peregrine would subject retailers of software products and items containing software or lenders taking security interests in the retailer's receivables to the filing requirements of the Copyright Act. This weakens the U.C.C.'s perfection regime and burdens commerce because retailers have a legitimate expectation that otherwise ordinary finance transactions will be governed by state law. After Peregrine, however, lenders must look to the underlying source of the receivable, which may be a mixture of software and noncopyrightable elements to determine their compliance obligations. A lender may no longer avoid making the federal filing by taking a security interest only in the accounts receivable and not in the copyrights themselves. Because the Copyright Act does not permit "blanket" filing, but rather requires registration and recordation of individual works, a lender must undertake a significant tracking and maintenance effort to comply with the federal requirements.

The federal priority system also creates uncertainty by preventing lenders from determining the existence of conflicting security interests. The Copyright Act priority scheme contains a "look-back" provision that requires a lender to wait up to three months after filing before it can be certain that no conflicting security agreement covering the property will take priority. Again, the U.C.C. system, which provides that the first to file receives priority, does not create such uncertainty.

(5) Peregrine's Impact on the Copyright Office

As a direct result of the holding in Peregrine, the Copyright Office has been forced to alter its procedures, thereby significantly increasing an applicant's uncertainty. The Copyright Office has experienced a substantial increase in the number of documents sub-

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103. See Carroll, supra note 3, at 1332 n.48.
104. Id.
105. For example, Peregrine would seem to compel a lender taking a security interest in a computer retailer's receivables to make a federal filing if that retailer sells "bundled" hardware and software packages.
106. See supra notes 95-96.
107. See supra note 70.
mitted for recordation in the last few years, particularly after Peregrine was handed down,\textsuperscript{108} leading to a backlog of up to nine months.\textsuperscript{109} Although in the past the Copyright Office screened submitted documents for obvious errors or discrepancies and brought these to the attention of the remitter, Peregrine has led to such an influx of filings that the Copyright Office can no longer perform this courtesy.\textsuperscript{110} As a result, applicants have lost an additional safeguard against error and its potential legal and economic consequences. Chapter 16 of the Compendium, which sets forth the Copyright Office's practices and procedures for recording transfers and other documents pertaining to copyrights (including security interests), is currently under review by the Office, primarily as a result of the Peregrine holding and related legislative activity.\textsuperscript{111} Certain copyright regulations\textsuperscript{112} are also being reviewed to determine whether they hinder recordation. Pending legislative and private reform proposals have thrown the Copyright Office into confusion and have rendered the once clear procedural framework "a jumble."\textsuperscript{113}

\section*{II. Reform Proposals}

A number of groups are currently studying the legal and practical issues raised by Peregrine,\textsuperscript{114} and at least three reform proposals have been published to date.\textsuperscript{115} Each attempt to remedy the present problematic state of the law meets with its own benefits and drawbacks.

\subsection*{A. The Article 9 Study Group Approach}

In early 1990 the Permanent Editorial Board for the Uniform Commercial Code ("P.E.B.")\textsuperscript{116}, with the support of the American Law Institute and the National Conference of Commissioners on Uniform State Laws, established the Article 9 Study Committee ("Study Group") to recommend changes to Article 9 of the U.C.C.\textsuperscript{116} As part

\begin{itemize}
\item \textsuperscript{108} Policy Decision, supra note 65, at 27074.
\item \textsuperscript{109} Telephone Interview with Bill Fralic, Staff Attorney, U.S. Copyright Office (Jan. 1, 1994).
\item \textsuperscript{110} Policy Decision, supra note 65, at 27074 ("Because of the increased number and complexity of documents submitted for recordation, the Office can no longer screen the documents for content and engage in correspondence with the remitter over apparent problems with the sufficiency of the document.").
\item \textsuperscript{111} Telephone Interview with Bill Fralic, Staff Attorney, U.S. Copyright Office (Jan. 1, 1994).
\item \textsuperscript{112} 37 C.F.R. §§ 201.4, 201.10, 201.25, & 201.26 (1992).
\item \textsuperscript{113} Telephone Interview with Bill Fralic, Staff Attorney, U.S. Copyright Office (Jan. 1, 1994).
\item \textsuperscript{114} See supra Part I.
\item \textsuperscript{116} P.E.B. REPORT, supra note 29, at 1.
\end{itemize}
of its review of Article 9, the Study Group developed an approach to security interests in federally regulated intellectual property rights.\textsuperscript{117} This proposed approach was designed to remedy the uncertainty inherent in the current regime concerning the extent of federal preemption\textsuperscript{118} and to bring the recording system in line with "common patterns of secured financing."\textsuperscript{119}

The Study Group recommended a tripartite system of recordation.\textsuperscript{120} This system would employ both the current state and federal schemes and would establish a federal "notice filing" overlay.\textsuperscript{121} Under the Study Group's approach, a security interest in federally regulated intellectual property, such as a copyright, could be perfected under either Article 9 or by filing in the federal index.\textsuperscript{122} A third recordation system, the "notice" system, would be established at the federal level to notify parties attempting to file in the index of prior Article 9 filings.\textsuperscript{123}

The Study Group also advocated revising federal and state law to provide that priority in general be determined on the basis of time of recordation.\textsuperscript{124} However, the proposed system is not strictly "first-to-file," like the U.C.C.\textsuperscript{125} For an Article 9 filing to be effective against

\textsuperscript{117} See supra text accompanying notes 87-90.

\textsuperscript{118} P.E.B. REPORT, supra note 29, at 53.

\textsuperscript{119} Id. at 50-51. The Study Group recognized that it would be working within certain political limits and thus recommended a scheme that was not necessarily ideal, but that could be approved by Congress:

From the perspective of those who finance intellectual property, the ideal clarification would result in a single set of substantive rules and a single filing system governing security and other interests in all types of intellectual property. The [Study Group] recognizes that this ideal is unlikely to be recognized. Congress cannot be expected either to cede the field totally to state law or to integrate and overhaul the federal systems.

\textsuperscript{120} Id. at 50-51.

\textsuperscript{121} Id. at 50-55.

\textsuperscript{122} For a copyright, the relevant federal index would be located at the Copyright Office. See supra text accompanying note 44.

\textsuperscript{123} The "notice" system would look a lot like an Article 9 filing. See supra note 37. Filed documents would be indexed on a "debtor's name" basis, and the filing of a single document would affect rights in all of the debtor's property of the kind described, including after-acquired property and the proceeds thereof. P.E.B. REPORT, supra note 29, at 55. The "notice" system also would "make effective a document that is filed before the security interest attaches." Id.

\textsuperscript{124} Id. at 51. The Study Group's proposal would eliminate or at least "substantially" reduce the Copyright Act's "look-back" period, during which a later transferee may take priority in certain situations. Id. at 54 n.7.

\textsuperscript{125} See supra note 70.
subsequent purchasers\textsuperscript{126} who record in the federal system, the state-perfected party must also have filed in the federal “notice” system.\textsuperscript{127} Thus, perfection may be achieved by making a first-in-time filing either in the federal index alone or under Article 9 if accompanied by a federal “notice” filing that precedes any conflicting federal filing.\textsuperscript{128}

The Study Group’s approach has significant benefits. First, the system acknowledges the contributions made by the U.C.C. to modern financing and updates the current regime to benefit from those contributions.\textsuperscript{129} Second, the Study Group’s approach accounts for the interests of parties who currently rely on their federal index filings and of certain third parties who may find the federal system more suitable for their purposes.\textsuperscript{130} Third, the Study Group system clarifies existing law and establishes a clear, albeit complex, regime for the perfection of security interests in copyrights. Finally, the Study Group’s approach would not require Congress to abdicate its current role completely\textsuperscript{131} and is therefore unlikely to generate substantial legislative resistance.

There are, however, a number of drawbacks to the Study Group’s system. First, it requires multiple filings under either the federal or state system. To file under the federal regime, the applicant must register the copyright\textsuperscript{132} and thus encounter many of the problems highlighted by the Peregrine decision.\textsuperscript{133} Filing under Article 9 allows the applicant to benefit from the U.C.C.’s accommodation of modern financing methods,\textsuperscript{134} but requires an additional federal “notice” filing to protect against a subsequent purchaser who files in the federal index.\textsuperscript{135} Second, because the federal system index works by registration number,\textsuperscript{136} a party wishing to file under Article 9 will have to make numerous searches for any transaction involving multiple copyrights. Third, the Study Group’s system is complicated and may en-

\begin{itemize}
\item \textsuperscript{126} “Purchaser” in this context includes a party taking a security interest. P.E.B. Report, supra note 29, at 51.
\item \textsuperscript{127} Id.
\item \textsuperscript{128} Id. at 55.
\item \textsuperscript{129} See supra text accompanying notes 36, 37, and 70.
\item \textsuperscript{130} “The [Study Group] recognizes that, although Article 9 filing systems work well for secured parties, the existing federal recording systems may be more suitable than state Article 9 filing systems for persons who take interests in intellectual property other than security interests.” P.E.B. Report, supra note 29, at 54. The Study Group seems to be concerned with the interests of a buyer for value who uses the federal index to examine title to specific indexed property.
\item \textsuperscript{131} P.E.B. Report, supra note 29, at 50-55.
\item \textsuperscript{132} See supra text accompanying notes 92-93.
\item \textsuperscript{133} See supra Part I(B).
\item \textsuperscript{134} See supra text accompanying notes 36, 37, and 70.
\item \textsuperscript{135} See supra text accompanying notes 121-128.
\item \textsuperscript{136} See supra note 92 and accompanying text.
\end{itemize}
gender confusion by providing the applicant with too many options. Finally, by preserving the federal index as a parallel recordation scheme, the Study Group perpetuates a dual system that does not reflect modern patterns of secured financing, is unnecessarily conservative, and is inconsistent with the Group's stated goals.

B. The ABA Task Force Approach

A second proposal comes from the American Bar Association Task Force on Security Interests in Intellectual Property. As part of its goal to suggest a comprehensive legal system governing security interests in intellectual property, the Task Force recommends a "mixed approach" for dealing with the issue of federal preemption and the related legal and practical problems resulting from the current state of the law. The Task Force approach would significantly alter the regime for perfecting security interests in copyrights.

The Task Force set out to develop a system that would accomplish three basic objectives: (1) enable a third-party to determine who has an interest in the property; (2) permit a perfected security interest to survive when rights are transferred from state law to federal law and vice versa; and (3) enable a secured party to encumber after-acquired property and proceeds from a license or sale based on the initial filing. The "mixed approach" largely meets these goals.

The Task Force has a similar approach to that of the Study Group, but rejects the federal index as a viable parallel recordation system. Security interests in federally perfected intellectual property, including copyrights, would be perfected by an Article 9 filing supplemented by a "notice" filing at the federal level on a debtor's name basis. The state filing would confer priority against lien creditors, secured creditors, and all third parties other than subsequent purchasers/assignees for value against whom the federal filing would

137. Cf. notes 68-69 and accompanying text (describing the Peregrine court's reasoning that multiple filing systems lead to uncertainty and undermine the effectiveness of each).
138. The Study Group's reasons for adopting this less than ideal scheme may actually be grounded in politics. See supra note 120.
139. The Business Law Section of the ABA established the task force in 1990 as a result of concern expressed by various groups about the "unsatisfactory" state of the law governing security interests in intellectual property. TASK FORCE REPORT, supra note 28, at 1.
140. The Task Force developed its recommendation with the goal of creating a system likely to be enacted by Congress, which deals responsibly with the interests of various parties, and which would provide certainty, ease of perfection, modest cost, and modest change. TASK FORCE REPORT, supra note 28, at 3.
141. Id.
142. Id. at 14.
143. Id. at 9.
be required to establish priority. The federal filing would be a copy of the form U.C.C.-1 filed at the state office with an appropriate cover sheet.

The primary advantage of the Task Force's report is its streamlining of the recordation process. While avoiding the federal system and all of its problems, the "mixed approach" would preserve most of the advantages of the state-law system, including debtor's name-based filing, coverage for after-acquired property, and first-in-time priority.

The Task Force approach also has certain disadvantages. It would require dual filings—one at the state and one at the federal level. This drawback is largely mitigated by the simple U.C.C.-like form of the federal filing. However, the sweeping changes proposed also present a jurisdictional problem because Congress may be unwilling to defer so extensively to state law in this area. The "mixed approach" also fails to clarify the role that federal registration will play in the "notice" filing requirement.

C. The Copyright Reform Act of 1993

In February 1993 Congressman Hughes introduced H.R. 897, the Copyright Reform Act of 1993. The bill proposed a number of major changes to the Copyright Act. Among the changes was a proposal to overturn the ruling in Peregrine by restricting the extent of federal preemption. Other reforms in the bill included eliminating the requirement that copyrights be registered for section 411(a) infringe-
ment suits and making the Register of Copyrights a presidential appointee.

Unfortunately, the bill’s proposal to overturn Peregrine was an inadequate response to the issues facing the software industry and other interested parties. By abrogating Peregrine without clearly defining the scope and applicability of state and federal law, the bill would have reinstated the uncertainty that plagued perfection of security interests in copyrights prior to Peregrine. In fact, the bill would have effectively increased the uncertainty by removing the only significant authority on the reach of the Copyright Act. Perhaps for these reasons, the Task Force submitted a statement to the House Subcommittee on Intellectual Property and Judicial Administration urging a more complete and effective overhaul of the Copyright Act.

After a number of amendments, the bill passed the House without the provision statutorily overturning Peregrine. Although a number of other key changes to the Copyright Act survived amendment, a chance for Congress to address the legal and logistical problems highlighted by Peregrine was lost.

IV. Going Beyond the Task Force Approach

All who have considered this issue will likely concede that the law governing perfection of security interests in copyrights should change, but the form that change should take remains an open question. Of the existing proposals, the Task Force’s approach is the most effective in encouraging the use of copyrights as collateral. This approach best reconciles the Copyright Act’s internal conflict between its policy of

153. See supra note 92 (discussing the registration requirement). The proposal to repeal § 411(a) received support from software publishers at a hearing on the Senate bill held by the Senate Subcommittee on Patents, Copyrights and Trademarks. See Legislation: Consensus Absent on Bill to End Mandatory Copyright Registration, 46 PAT. TRADEMARK & COPYRIGHT J. 536 (1993).
154. H.R. 897.
155. See supra Part I(A).
156. TASK FORCE REPORT, supra note 28, at 14 n.22.
157. The amendments focused largely on simplifying the current registration procedures. Changes to the Bill included provisions for public hearings on how to make the registration process easier, the development of a short-form registration application, and preserving the validity of an application containing errors made in good faith or in reliance on counsel. See H.R. 897.
159. See H.R. 897. The other provisions discussed supra in the text accompanying notes 154-155 remained intact. Id.
160. Notably, the bill proposes repeal of the registration prerequisite to infringement actions. See H.R. 897.
161. See supra Part I(C).
encouraging innovation and its outdated transactional provisions, while favorably resolving the interplay between state and federal law by downplaying federal involvement. Although the Task Force's approach is not without its problems, if legislative resistance makes an "ideal" system impossible, this Note advocates adoption of the Task Force's approach wholesale. However, the Study Group and the Task Force may be mistaken in their appraisal of the political obstacles to the creation of a more desirable regime. To account for this possibility, the remainder of this Note will grapple with these obstacles.

The software industry has a strong interest in seeing that enforcement of the Copyright Act does not hamper its ability to obtain the greatest possible leverage from its copyrights. If satisfying this interest were the only concern, the best approach would be to exclude the federal system from any role in the perfection of security interests in intellectual property. State U.C.C. regulation more adequately accommodates modern financing practices and provides stability and predictability to business relationships. In contrast, the Copyright Act barely speaks to security interests and contains outdated priority concepts. Furthermore, since the U.C.C. applies to all other forms of personal property, exclusive application of Article 9 would promote certainty if applied to copyrights as well. Software companies in particular would benefit from a strictly U.C.C. system because unfinished or unpublished programs, protected solely under state trade secret law, would receive continuous protection as they become subject to the Copyright Act. Moreover, a strictly U.C.C. system would resolve the problems faced by software vendors concerning the use of copyright-related receivables as collateral.

However, there are other issues that must be considered in determining the best approach. As both the Study Group and the Task Force acknowledge, Congress may resist calls to limit federal participation in the field. Presumably, this resistance will be based on something more than a desire to perpetuate existing bureaucracies. Federal copyright policy, the interests of third party buyers who rely upon the federal index for title information, and the power of the fed-

162. See supra notes 9-10.
163. See supra Part I(C).
164. See supra text accompanying notes 17-27.
165. See supra Part I(C).
166. Mesrobian & Schaefer, supra note 37, at 832.
167. See supra note 13 (discussing trade secrets and their relation to the Copyright Act).
168. See supra notes 89-107 and accompanying text.
eral government's traditional role as repository for title transfer records\textsuperscript{170} each must be weighed against industry interests.

(1) Copyright Policy

Congress must be mindful of the policies behind the Copyright Act\textsuperscript{171} as first set forth in the Constitution.\textsuperscript{172} These policies would be furthered best by dismantling the federal recordation system. Neither the protection of the public domain, the protection of the author, nor the promotion of learning requires that federal law control the perfection of security interests. Both the public domain and the author will be safeguarded, whether state or federal law applies, because these policies concern the more substantive issues of the nature of copyrightable material on one hand and the rights of exclusivity on the other.\textsuperscript{173} Further, the federal system works against the "keystone" goal of promoting learning\textsuperscript{174} because it places logistical hurdles in front of parties wishing to perfect security interests in copyrights and thus reduces incentives to create and publish new works.\textsuperscript{175} Federal copyright policy is not an obstacle to a completely state law system.

(2) The Interests of Third Parties

Third parties have an interest in retaining some federal involvement in any new recordation system. The Copyright Act provides for recordation of transfers of title,\textsuperscript{176} and buyers in ordinary course can search the federal index to determine ownership.\textsuperscript{177} If the index also contained information regarding security interests in the related copyrights, as Peregrine suggests,\textsuperscript{178} a third party could search all claims in one location. A lender's interest and a buyer's interest are not identical, and the federal system as it currently stands may reduce certain small-transaction buyer costs at the lender's expense. The Study

\textsuperscript{170} Congress has long provided for copyright registrations and exchanges to be reflected in a federal copyright record. See Weinberg and Woodward, supra note 15, at 439 (discussing the history of the federal role in this area and asserting that copyright law provided a filing statute as far back as 1870). See also 17 U.S.C. § 205 (1988 & Supp. V 1993); Task Force Report, supra note 28, at 7.

\textsuperscript{171} See Patterson & Lindberg, supra note 83.

\textsuperscript{172} See supra note 10.

\textsuperscript{173} See Patterson & Lindberg, supra note 83, at 50-52.

\textsuperscript{174} Id. at 49-50.

\textsuperscript{175} See supra notes 14-17 and accompanying text.


\textsuperscript{177} The "collateral assignment" concept employed by the Copyright Act complicates this analysis because a taking of a security interest so conceived is in effect a transfer of title. See supra note 51. Thus, any meaningful reform which seeks to preserve the role of the Copyright Act as a repository for title transfer information other than security interests must account for the collateral assignment concept.

\textsuperscript{178} See supra Part I(B).
Group's proposal attempts to protect the interests of buyers and others relying on the federal index by retaining the federal system.\textsuperscript{179} The Task Force's approach discounts this interest as insignificant relative to the harm done by perpetuating the federal index system and thus refers to the Study Group's proposal as "a step backward."\textsuperscript{180} Whatever the case, to the extent that members of the software industry rely on the federal index when buying copyrights, the industry may have some residual interest in maintaining at least some aspects of the federal system.

(3) \textit{The Role of Tradition}

Closely tied to the interests of third parties is the power of tradition supporting the current regime.\textsuperscript{181} Reliance on the part of lawyers, grown out of the historical attachment of the intellectual property bar to federal index systems,\textsuperscript{182} may be a substantial argument in favor of perpetuating these systems. Familiarity with a recordation scheme promotes predictability and stability. However, given that the alternative is the far less cumbersome and complex U.C.C. system,\textsuperscript{183} such a tradition hardly seems worth preserving, particularly in light of the rapidly changing nature of some of the property it governs.\textsuperscript{184}

Therefore, none of the foregoing interests and policies should prevent Congress from relinquishing its control over the recordation of security interests in copyrights.

(4) \textit{Toward Complete State Law Preemption}

If the Copyright Act were changed to provide for complete state law preemption, the best approach would be twofold. First, section 301 should be altered in the manner set forth in the first version of H.R. 897\textsuperscript{185} to provide that the Copyright Act does not apply to the perfection of security interests. Second, section 205 should be amended to revamp the concept of title to conform with a more modern bundle-of-rights conception.\textsuperscript{186} Under the new section 205, recordation of transfers would apply to a transfer of copyright ownership\textsuperscript{187}

\begin{footnotesize}
\begin{itemize}
\item 179. See supra Part II(A).
\item 180. TASK FORCE REPORT, supra note 28, at 14.
\item 181. See supra note 78.
\item 182. TASK FORCE REPORT, supra note 28, at 14.
\item 183. See supra note 78.
\item 184. Mesrobian & Schaefer, supra note 37, at 828.
\item 185. See H.R. 897.
\item 186. See supra note 51.
\item 187. Ownership here is used to denote the holding of a copyright itself. See 17 U.S.C. § 201(a) (1988).
\end{itemize}
\end{footnotesize}
or to any of the exclusive rights obtained thereby,188 but not to a security interest. Thus, the U.C.C. would contain the only recordation scheme and would provide the priority rule. These changes would significantly overhaul the Copyright Act and would effectively cede perfection of security interests in copyrights to state law. Article 9 would not need major changes, although amendments to the commentary would probably be desirable.189

The magnitude of the changes required for such a revamping led both the Study Group and the Task Force to eschew proposing such sweeping reforms.190 Although political pragmatism has its merits, these reformers have not taken strong enough steps to remedy the problems in the field. At least one group of legislators was willing to overturn Peregrine.191 This encouraging sign should be taken as the signal to provoke a full-scale overhaul of the Copyright Act.

**Conclusion**

The current rules governing the perfection of security interests in copyrights are simply too cumbersome and confusing to encourage the use of copyrights as collateral. Burdensome filing requirements, legal uncertainty, and logistical complexity have prevented software companies from maximizing the value of their copyrights—often their most important assets. This is the unfortunate result of the application of the outmoded federal regime in areas in which it serves no significant policy interest.

Three recent reform proposals have attempted to address this problem, but only one of them effectively deals with the many problems in the field. Even this approach does not sufficiently encourage growth and innovation by software companies. This Note proposes that the Copyright Act be substantially amended so that state law govern the perfection of security interests in copyrights.

188. See supra note 9.
189. See supra notes 38-47 and accompanying text.
190. See supra Part II(A) (Study Group) and Part II(B) (Task Force).
191. See supra note 152 and accompanying text.