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PAUL HEALD'S "RESOLVING PRIORITY DISPUTES IN INTELLECTUAL PROPERTY COLLATERAL": A COMMENT

Robert H. Rotstein*

INTRODUCTION

In Resolving Priority Disputes in Intellectual Property Collateral, Paul Heald sheds light on a complex and seemingly arcane area of the law—the conflicting priorities among holders of security interests in intellectual property. Most topical is Professor Heald's discussion of security interests in copyrighted material, a subject of both recent case law and proposed legislation.

As summarized more fully below, Heald's major thesis is that, although section 205 of the Copyright Act of 1976 preempts certain aspects of state law governing security interests in copyrights, it does not preempt all state law. In particular, Heald believes that state laws governing the priorities between unperfected secured creditors, or between an unperfected secured creditor and a trustee-in-bankruptcy, survive federal preemption. In this regard, he criticizes the recent opinions in In Re Peregrine Entertainment, Ltd. and AEG Acquisition Corp. because they hold that the Copyright Act preempts state commercial codes purporting

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* Partner, Rosenfeld, Meyer & Susman, Beverly Hills, California. I wish to thank Steven Fayne and Donald Karl for their valuable comments and suggestions.


5 Peregrine, 116 B.R. at 194.

6 AEG, 127 B.R. at 34.
to resolve the rights between a trustee-in-bankruptcy and an unperfected secured creditor.

Given the current interest in security interests in copyrights, this paper will limit its remarks to Heald's discussion of copyright law. This paper first suggests, contrary to Professor Heald's conclusion, that under section 205(d) of the Copyright Act of 1976, Congress has indeed preempted state commercial law in a way consistent with the holdings of Peregrine and AEG.

Second, the paper examines the practical considerations underlying the decisions in Peregrine and AEG by describing how the cases reflect longstanding practice among those engaged in giving and taking security interests in copyrights. Third, this paper briefly considers Peregrine and AEG in light of recent copyright "theory" and suggests that criticism of those cases reflects a trend in copyright law toward reassimilating a Romantic concept of "authorship."

Finally, this paper addresses two issues Professor Heald does not expressly mention, yet that bear on the nature of the current system regulating security interests in copyrights: (1) the relationship between a security interest in the intangible copyrights, on the one hand, and in the tangible property in which the copyright is embodied, on the other; and (2) the treatment of security interests in the proceeds derived from a debtor's exploitation of its copyrights.

I. THE COPYRIGHT ACT AND CONFLICTING SECURITY INTERESTS

A. SUMMARY OF PEREGRINE AND OF PROFESSOR HEALD'S POSITION

In Peregrine, a creditor savings and loan took a security interest in the debtor's film library. The creditor filed a financing statement with the California Secretary of State under the California Commercial Code, but did not record its interests with the United States Copyright Office under section 205 of the Copyright Act of


18 116 B.R. at 194. Because AEG essentially adopted the reasoning in Peregrine (see AEG, 127 B.R. at 40-41, 43-44), I will focus my remarks on Peregrine.
1976.\textsuperscript{9} The debtor filed a proceeding under Chapter 11 of the Bankruptcy Code. Invoking the applicable provisions of the Code, the debtor-in-possession asserted a judicial lien on the copyrights. In this way, the debtor sought to avoid the secured creditor's interest on the ground that, by failing to record its security interest with the Copyright Office, the creditor was unperfected and therefore junior to the debtor-in-possession.\textsuperscript{10}

Judge Kozinski, sitting by designation, held that section 205 of the Copyright Act preempts state law recordation and priority systems. As a result, the secured creditor's filing in the state office under the California Commercial Code was insufficient to perfect its security interest in the debtor's copyrights. Moreover, as a matter of bankruptcy law, the debtor-in-possession (tantamount to a trustee-in-bankruptcy) would be deemed to have recorded its interest with the Copyright Office. By virtue of such recordation, the debtor-in-possession had priority under section 205(d) of the Copyright Act as a judicial lien creditor who recorded in the Copyright Office and took in good faith, without notice, and for consideration.

Professor Heald does not reject the notion that federal copyright law preempts much of state commercial law governing security interests. He acknowledges that section 205(d) of the Copyright Act settles two priority disputes between transferees of interest in a copyright: "(1) when the first transferee files first in the Copyright Office (first transferee wins); and (2) when a subsequent transferee for value and in good faith files first in the Copyright Office without notice of a prior unrecorded transfer (second transferee wins)."\textsuperscript{11} Heald agrees that a state law system inconsistent with the foregoing scheme would be preempted by federal copyright laws.\textsuperscript{12}

Nevertheless, Heald argues that Congress has left untouched certain aspects relating to conflicting priorities. In particular, Heald posits that the Copyright Act provides no express answer on the issue of priority if neither transferee records, if the subsequent

\textsuperscript{10} \textit{Peregrine}, 116 B.R. at 198.
\textsuperscript{11} Heald, \textit{supra} note 1, at 139.
\textsuperscript{12} \textit{Id.} at 138.
transferee is the trustee-in-bankruptcy, or if the copyright at issue is unregistered. He reasons that, consequently, "a court would not be justified in holding that in section 205 Congress has impliedly preempted all Article 9 priority rules, especially those that do not conflict with section 205." Thus, a court should apply state law in deciding priorities between two unrecorded transfers, between an unrecorded transfer and a trustee-in-bankruptcy, or where an unregistered copyright is at issue.

The ramifications of Heald's position could be far-reaching. Although the states have adopted Article 9 of the Uniform Commercial Code (or variants thereof) and thus now have relatively uniform laws, presumably Heald would permit state legislatures to amend their commercial codes to alter or vary the laws governing priorities among unrecorded transfers of copyright interests. Conceivably, fifty different state systems could coexist.

Heald criticizes Peregrine and AEG because, contrary to his own conclusion, they hold that federal law does preempt state law rules governing the conflicting interests of a trustee-in-bankruptcy and a creditor who fails to record in the Copyright Office. Specifically, he quarrels with the holding in Peregrine (and in AEG, which followed Peregrine) that, as a matter of federal preemption, an unperfected security interest cannot prevail as against a debtor-in-possession, who under the Bankruptcy Code, enjoys the status of a judicial lien creditor.

Heald finds Peregrine and AEG "highly suspect" in concluding that the trustee-in-bankruptcy was deemed to have filed in the Copyright Office. He notes that under the law of California and most states, a judicial lien creditor (the analogue to the trustee-in-bankruptcy) need not file in the United States Copyright Office as a prerequisite to perfecting its lien on intellectual property, and that Peregrine and AEG erred in declaring otherwise. According to Heald, it follows that, because the trustee and the secured creditor in Peregrine and AEG had conflicting interests as to which section 205(d) of the Copyright Act is silent, Article 9 of the Uniform

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13 Id. at 138-39.
15 Heald, supra note 1, at 144.
Commercial Code governs.\textsuperscript{16} For Heald, the evil of \textit{Peregrine} and \textit{AEG} is that they deny the states the right to “tinker with the priority relationship between lien creditors and those who provide notice of a security interest by filing with the state.”\textsuperscript{17} But why should the states have the right to “tinker” with such priority relationships? Professor Heald proffers no policy reasons, relying instead on statutory construction and case law. As discussed in the following subsection, however, Heald’s conclusions do not necessarily flow from the language of the Copyright Act.

B. A REEXAMINATION OF SECTION 205

Heald’s criticism of \textit{Peregrine} and \textit{AEG} rests on two premises, each of which may be questioned. First, he posits that section 205(d) of the Copyright Act does not speak to who has priority in the case of two unperfected creditors. Second, he states that, because under state law a judgment creditor need not file with the Copyright Office to perfect a judicial lien, \textit{Peregrine} and \textit{AEG} erroneously found that the trustee-in-bankruptcy had filed with the Copyright Office. However, neither of these premises inevitably follows from the language of the Copyright Act or the case law.

1. \textit{Section 205(d) of the Copyright Act and Unrecorded Transactions.} Heald first argues that section 205(d) of the Copyright Act does not establish priorities among unrecorded transactions, or among unrecorded transactions and a trustee-in-bankruptcy. However, it is not clear from the statutory language that this is so. Rather, one could construe section 205(d) as implicitly providing that, as between two unperfected secured creditors, the creditor whose transaction was executed first prevails.

The first sentence of section 205(d) sets forth the situations in which the transfer executed first will always prevail, irrespective of whether the second transfer was recorded or executed in good faith, without notice, or for consideration. Under this first

\textsuperscript{16} Id. at 146. This conclusion would not, under Professor Heald’s view, mandate a different result under \textit{Peregrine}, since the secured creditor’s failure to record in the Copyright Office meant that it had not perfected its interest even under the California Commercial Code, which itself required a federal filing. \textit{Id.} at 147.

\textsuperscript{17} Id. at 148.
sentence, when the first transfer is recorded in the Copyright Office first, the first transferee always wins. On this, there is no disagreement.

However, Professor Heald's interpretation of the second sentence of section 205(d) is open to question. The second sentence provides that a second transfer prevails "if recorded first [as required by section 205], 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."16 The second sentence of section 205(d) can be interpreted to prescribe the only instances where the second transaction can prevail over the first: (1) if the second transaction is recorded first; (2) if it is taken without notice of the first transaction; (3) if it is for valuable consideration; and (4) if it is made in good faith. Where any of these conditions are absent, the second transfer cannot prevail.

Significantly, according to this construction, recordation is an absolute precondition for the second transferee to have priority. So, an unrecorded second transaction could never prevail as against an unrecorded prior transaction.19 If this is the case, then contrary to Professor Heald's argument, section 205(d) at least implicitly resolves the issue as to the priority of conflicting unrecorded transfers: a first unrecorded transaction has priority over a second unrecorded transaction (or over a second recorded transaction entered into with notice, in bad faith, or without consideration). Any state law to the contrary would be preempted. For example, the states could not, consistent with section 205(d), pass a statute giving an unrecorded second transferee priority over an unrecorded first transferee, merely because the second transferee took without notice, in good faith, and for consideration. Such a reading of section 205(d) would therefore mean that federal law governs the fact situation presented in Peregrine and AEG, and that those cases

19 Indeed, Professor Heald recognizes that, by negative inference, section 205(d) provides that where there is notice, bad faith, or lack of consideration, the second transaction can never prevail over an earlier unrecorded transaction. Heald, supra note 1, at 143 n.46. In drawing this negative inference, however, he does not mention the additional requirement that to have priority, the second transfer must also be recorded.
were decided correctly as they relate to preemption.²⁰

2. Perfection by a Trustee-in-Bankruptcy of Its Hypothetical Judicial Lien in a Copyright. While the foregoing interpretation of section 205(d) would mean that the *Peregrine* court properly applied federal copyright law in reaching its decision, it does not necessarily mean that Judge Kozinski correctly held that a trustee-in-bankruptcy must prevail over an earlier unperfected secured creditor. Rather, to have priority, the trustee must satisfy the conditions of the second sentence of section 205(d), including recordation of its interest with the Copyright Office. *Peregrine* held that, as a matter of bankruptcy law, the trustee would be deemed to have exercised all rights necessary to perfect its lien, which included recordation in the Copyright Office.²¹

Professor Heald finds it problematic that the courts in *Peregrine* and *AEG* so easily found that the trustee-in-bankruptcy would be deemed to have recorded in the Copyright Office. Recall that the trustee-in-bankruptcy enjoys the status of a judgment lienor. Heald reasons that, because a judgment lienor as a matter of state law need not perfect its lien by filing with the Copyright Office, *Peregrine* erred in holding that the trustee-in-bankruptcy had made such a filing.

The problem is, however, that *Peregrine* stands for the proposition that, notwithstanding state law to the contrary, as a matter of federal copyright law under section 205(a), a judgment lienor must file in the Copyright Office to perfect its lien. Judge Kozinski evidently believed that state law cannot determine when a judgment lienor has perfected its interest in a copyright. For this reason, to say that a judgment lienor is perfected as a matter of state law is beside the point: perfection requires a federal filing. And according to bankruptcy law, if the trustee must file under the Copyright Act to perfect its lien, it will be deemed to have done so. In sum, Professor Heald’s reliance on state law regarding perfection of a judgment lien in a copyright does not really address the

²⁰ I recognize that the above interpretation of section 205(d) is not inevitable. Indeed, one could object that the construction unjustifiably inserts the word “only” in front of the word “if” in the second sentence of section 205(d). Nevertheless, the interpretation is certainly plausible and thus deserves further analysis.

preemption issue raised in *Peregrine*.

Moreover, even if Professor Heald is right that a judgment lienor is not required to record in the Copyright Office to perfect its lien, *Peregrine* was still correctly decided. Judge Kozinski writes: "Under 11 U.S.C. § 544(a)(1), not only is the debtor-in-possession given the rights of a judicial lien creditor, it is also deemed to have exercised those rights in their entirety." Such a concept is not merely Judge Kozinski's creation out of whole cloth. Rather, *Peregrine* cites the Ninth Circuit's opinion in *Sampsell v. Straub* for that proposition. Thus, irrespective of whether a judicial lien creditor must file with the Copyright Office, there is little question that it may (i.e., has the right to do so), and as a matter of bankruptcy law, will be deemed to have exercised this right.

In summary, neither case law nor statutory construction inevitably leads to the conclusion that *Peregrine* is incorrectly decided. As a result, pragmatic and theoretical considerations more directly come into play. The next section of this paper discusses certain of those considerations.

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22 *Peregrine*, 116 B.R. at 207 n.19.
23 194 F.2d 228, 231 (9th Cir. 1951) ("[T]he trustee is given all the rights which a creditor with a lien by legal or equitable proceedings would enjoy."), cert. denied, 343 U.S. 927 (1952). *Peregrine* cites the Ninth Circuit at 116 B.R. 207 n.19.
24 Professor Heald does not address the language in *Peregrine* regarding the rights of a trustee. Rather, he focuses on language in *AEG*, regarding what a judicial lien creditor must do under state law. See *Official Unsecured Creditor’s Comm. v. Zenith Prods. (In re AEG Acquisition Corp.)*, 127 B.R. 34, 43 (Bankr. C.D. Cal. 1991) (discussing how the status of a lien creditor is determined by the specific language of the state statute at issue). Yet, the latter language does not end the inquiry since a trustee-in-bankruptcy may take advantage of all rights a judicial lien creditor could have, whether necessary or not to perfect a lien.
25 One might also question Heald's statement, admittedly held by others (e.g., Judith A. Gilbert & William P. Streeter, *Film Industry Bankruptcy: Securing the Right to Payment Before It Happens*, 26 *BEV. HILLS B. ASSN. J.* 175, 177 (1992) (discussing film industry bankruptcy and security mechanisms for creditors, and providing critical analysis of *Peregrine*)), that interests in unregistered works may not, under the Copyright Act, be recorded, and that the Copyright Act thus does not preempt state laws governing security interests in unregistered copyrights. Section 205 of the Copyright Act does not exactly provide that unregistered copyrights may not be recorded. Rather, section 205(a) provides that any transfer of an interest may be recorded. 17 U.S.C. § 205(a) (1988). By its terms, this provision would seem to include a transfer of an interest in an unregistered copyright. Section 205(c) merely provides that, unless the copyright is registered, recordation in the Copyright Office does not provide constructive notice of the transfer.
26 One could argue, therefore, that Congress provided for recordation of unregistered copyrights, but as an incentive to registration, provided that such recordation would not give

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II. OBSERVATIONS ON PRACTICE AND THEORY

A. PRACTICAL CONSIDERATIONS

As Heald's article and other commentary demonstrate, Peregrine and AEG have generated a certain amount of controversy and criticism. From a practical standpoint, it is difficult to understand why. On its face, the Peregrine decision may seem harsh in depriving a secured creditor—which at least attempted to perfect its interest through properly filing a financing statement with the state—of its priority vis-à-vis the debtor-in-possession. On closer examination, however, the result is not so harsh as it first appears. Broadly, all systems of priority will in certain instances result in unfortunate results for one party or another. For example, under section 9-312(5) of the Uniform Commercial Code, a second transferee who files first has priority over the earlier transferee, even where the subsequent transferee has notice of the first transfer. Obviously, the first transferee will question the fairness of permitting the subsequent transferee to have priority.

More particularly, the secured creditor in Peregrine failed to follow established practice in the motion picture industry, according to which secured creditors have traditionally recorded their interests first and foremost with the Copyright Office, and as a matter of prudence, in the appropriate state office as well.

constructive notice of the transfer. This construction makes sense if a subsequent transferee who searched the records of the Copyright Office would be deemed to have actual notice of a transfer in an unregistered copyright. If so, then Congress has not been silent on the question of unregistered copyrights, and an argument might be made that federal law would preempt state laws that purport to govern priority disputes over interests in unregistered copyrights.


E.g., CAL. COM. CODE § 9312(5) (West 1990).

E.g., Gary Concoff, Motion Picture Secured Transactions Under the Uniform Commercial Code: Problems in Perfection, 13 UCLA L. Rev. 1214, 1219-20 (1966) (advising the secured creditor to record in all jurisdictions whose law might control the secured transaction); Steven E. Fayne, Copyright As Collateral, L.A. COUNTY B. ASSN. J. (1984). See Observations and Concerns of The American Film Marketing Association, The Affiliated Financial Institutions of The American Film Marketing Association, The Directors Guild of...
Obviously, if the creditor in *Peregrine* had followed this practice, it would not have lost its priority vis-à-vis the debtor-in-possession. The *Peregrine* holding therefore did not frustrate commercial expectations and is not objectionable on that ground.

*Peregrine* not only reflects longstanding practice, but is also consistent with the scheme preferred by those most closely involved with secured transactions in copyrighted material. Creditors, debtors, and interested third parties alike generally seem to favor a broadly preemptive federal system governing recordation and priority of security interests in copyrights.

For example, a group of financial institutions, motion picture producers and distributors, and entertainment industry labor organizations has recently taken a position favoring the holding in *Peregrine*. The motion picture industry (as well as the record industry and the computer software industry) is, it may be said, "work" oriented rather than "debtor" oriented. For example, creditors with a security interest in a film focus on the work itself as the means of identifying conflicting security interests. Thus:

Motion pictures are works of enormous complexity. They rarely, if ever, consist of a single right developed by a lone party for exploitation in a discrete market. Instead, motion pictures consist of a collage of rights, often owned by different parties, at different times, for exploitation in a variety of media.

... Any motion picture, therefore, may have a host of security interests which affect it. How do interested parties in the motion picture business determine who has a security interest in a particular motion picture and what the security interest covers?

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America, The Screen Actors Guild, The Writers Guild of America, West with Respect to Section 101 of the Copyright Reform Act of 1993, at 6 (June 8, 1993) [hereinafter AFMA] (on file with the American Film Marketing Association) (noting that the decisions in *Peregrine* and AEG confirm "long-standing" and "well-understood" practice).

29 AFMA, supra note 28.

30 Id. at 6-7.
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Under the current system, the answer is easy: search the record in the Copyright Office. The Copyright Office maintains a work-based register.\(^{31}\)

State recording systems, however, are "debtor" based.\(^{32}\) In a state filing system, knowing the identity of the work does not help; rather, to conduct a search, one must know both the identity of the debtor and the debtor's domicile. The proliferation of possible debtors with different domiciles leads many involved in motion picture financing to believe that a state system of recordation, i.e., recordation under the Uniform Commercial Code, would increase expense and confusion.\(^{33}\)

Lending institutions favor a federalized system of recordation because they believe that such a system affords them more certainty as to who has rights in a particular work. Conversely, the motion picture producers believe that the uncertainty of a debtor-based state law system could hinder their ability to borrow by making lenders more reluctant to lend. The Writers, Directors, and Screen Actors Guilds, which take security interests in motion pictures to secure payment of compensation for their members' performances, also support the present system, perhaps out of a sense of cautious conservatism.\(^{34}\)

In short, critics of *Peregrine* may not have much of a constituency among those who actually participate in secured transactions. While the motion picture industry may not comprise the full panoply of entities with an interest in recordation and priority in secured transactions in copyrighted material, that industry certainly plays a prominent role.

In reaching his conclusions, Professor Heald largely ignores these broad contours of commercial practice.\(^{35}\) As a basic proposition,

\(^{31}\) Id.

\(^{32}\) Id.

\(^{33}\) Id. at 5.

\(^{34}\) AFMA, *supra* note 28, at 5.

\(^{35}\) In fairness, it does not seem to be the object of Heald's article to discuss whether federal law *should* be amended to provide for recordation of such security interests, or alternatively, whether existing state law is inadequate. Nonetheless, in light of the preference in the commercial world for a federal system of recordation and priority, it is undoubtedly important to ask whether, in the long run, a state system would be adequate.
broad federal preemption would serve the interests of those in the business of giving and taking security interests in copyright. Indeed, copyright exists to encourage the production and dissemination of works of authorship. This policy clearly has federal (and constitutional) dimensions. An important segment of those involved in copyright-related financing fear that a state-based system could actually impede the production and dissemination of copyrighted works by making financing less available. For this reason, permitting the states to alter priority schemes (even in the narrow area of unrecorded interests) could arguably interfere with the purposes of the federal copyright laws. If this is so, the decisions in *Peregrine* and *AEG* are defensible.

**B. THEORETICAL CONSIDERATIONS**

While the question of priority in security interests might seem relatively immune to theoretical discussion, the antipathy that some have to the concept of federal preemption may in fact have interesting theoretical underpinnings. In particular, the preference for a state law debtor-based system of recordation arguably reflects an adherence to a concept of authorship that has its genesis in Romantic thought and that has recently become the focus of much discussion.

Peter Jaszi and others have noted that the concept of “authorship” is a construct that flowered during the ascendancy of Romantic thought in the nineteenth century. During the nineteenth century, the Romantics considered the author-genius the central object of literature. For example, Wordsworth wrote that “[p]oetry is produced by a man of more than usual organic sensibility.” According to this Romantic vision of authorship, the work that was original reflected the author’s genius and enjoyed a

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37 See Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141 (1989) (holding that Florida statute prohibiting use of direct molding process to duplicate unpatented boat hulls conflicts with federal patent laws and is preempted).

38 Jaszi, supra note 36, at 463.

privileged relationship vis-à-vis the higher arts.\textsuperscript{40}

In more modern times, copyright law has rejected this Romantic notion of authorship, focusing instead on the copyright system as a method of encouraging dissemination of valuable works and not as a means of rewarding “authors.”\textsuperscript{41} Nonetheless, very recently, the Romantic notion of the author has reemerged in copyright, for example, in debates about moral rights.\textsuperscript{42}

I suggest (though I do not direct this point against Professor Heald) that antagonism toward a federalized system of recordation can be viewed as yet another manifestation of the reemergence of the concept of author in copyright. As discussed above, the state indexing system relating to security interests is debtor based. Very often, the debtor will be the “author” for the purposes of copyright. Deference to state recordation systems therefore means, in some sense, deference to authorship.

By contrast, the federal work-based system is antagonistic to the concept of “author.” A search of the federal filing system, though it may reveal individuals or entities claiming rights in a work, nevertheless focuses on the “work.” The question of who authored the work is secondary. In this way, the difference between the federal system of recordation and state commercial indexing systems reflects a longstanding tension between “author” and “work.”

The relevance of such theoretical discussions to what appears to be a mundane form of commercial transaction may seem questionable. Yet historically, many decisions in copyright law have

\textsuperscript{40} Burrow-Giles Lithographic Co. v. Sarony, 111 U.S. 53 (1884), reflects how copyright law during the nineteenth century assimilated Romantic thought. In \textit{Burrow-Giles}, the Supreme Court for the first time held that copyright extended to photographs. In concluding that a photographer was an “author,” the Court stated: “The third finding of fact says, in regard to the photograph in question, that it is a ‘useful, new, harmonious, characteristic, and graceful picture, and that plaintiff made the [photograph]... entirely from his own original mental conception, to which he gave visible form...’. \textit{Id.} at 60. This language bespeaks a decidedly Romantic approach to authorship and the copyrighted work.

\textsuperscript{41} In Alfred Bell & Co. v. Catalda Fine Arts, Inc., 191 F.2d 99 (2d Cir. 1951), the issue was whether mezzotint engravings of paintings of the old masters were entitled to copyright protection. In holding these engravings copyrightable, Judge Frank eliminated the Romantic idea of author from the determination of originality. Now, “[n]o matter how poor artistically the ‘author’s’ addition, it is enough if it be his own.” \textit{Id.} at 103. As noted by Jaszi, \textit{supra} note 36, and others, Romantic thought has recently begun to reemerge in copyright law.

\textsuperscript{42} Jaszi, \textit{supra} note 36, at 485, 492.
observed underlying tensions between the role of the author and the notion of the work as a form of speech that has value to the public. In considering how a system of recordation and priority should function, it is important to pause and examine whether such traditional tensions underlie the various arguments for and against a particular system.

III. PROBLEMS WITH PEREGRINE AND AEG

Although the above discussion defends Peregrine and AEG to a certain extent, aspects of the opinions relating to conflicting priority (not discussed by Professor Heald) are indeed problematic. More specifically, the cases raise at least two additional and interesting questions concerning: (1) the relationship between a creditor's security interest in the intangible copyright, on the one hand, and in the tangible property in which the copyright is embodied, on the other; and (2) the rules governing security interests in the proceeds from copyrighted works.

A. INTANGIBLE COPYRIGHT, TANGIBLE PROPERTY

A first issue apparently not considered in Peregrine is whether, notwithstanding the creditor's unperfected interest in the intangible copyright, the creditor's Article 9 filing gave it a security interest in the tangible property in which the copyrights were embodied (i.e., in the actual reels of film from which the motion pictures could be exhibited, or in the negatives from which the motion pictures could be reproduced). This question is not academic and indeed could ameliorate the impact of Peregrine on a secured creditor.

In Peregrine, the security at issue was a film library. Although the secured creditor lost its interest in the copyrights, it still could

43 See, e.g., id. at 485-96 (discussing how this tension permeates such seemingly technical issues as "works-made-for-hire" and copyright renewal and reversion).

44 Given Professor Heald's recognition of federal preemption of important areas of copyright, this discussion of theory is not primarily addressed to his Article. However, one could certainly argue that the proponents of the Copyright Reform Act of 1993, H.R. 897, 103d Cong., 1st Sess. (1993), who argue for a dual federal and state system of recordation, may be influenced by ingrained preferences for authorship.
have had bargaining power as against the debtor-in-possession if it could have retained priority as to the tangible property and thereby deprived the debtor-in-possession of access to this property (the negatives or prints).

The *Peregrine* court demonstrated some willingness to extend its holding to more than just pure security interests in a copyright. This might mean, for the court, that federal copyright law would preempt state law in connection with the tangible property in which the copyright is embodied. However, one of the most firmly ingrained doctrines in copyright law is that the ownership of a copyright is distinct from the material object in which the work is embodied. Thus, under section 202 of the Copyright Act, transfer of the material object does not transfer the copyright.

Therefore, in *Peregrine*, the creditor's state law Article 9 filing perfected its security interest in the tangible property in which the copyright was embodied even though the creditor's interest in the copyright was unperfected. Consequently, the secured creditor in *Peregrine* should have had priority as against the trustee-in-bankruptcy in connection with the tangible property. Such a result would give a creditor significant clout, especially where the creditor has possession of the collateral. By depriving the trustee-in-bankruptcy of the tangible property, a secured creditor might hinder the trustee's ability to exploit the copyright and in that way force the trustee to settle with the creditor.

Could the secured creditor in *Peregrine* have deprived the debtor-in-possession of access to the tangible property and thereby thwarted the debtor's attempt to exploit the copyright? The answer is unclear. In *Community for Creative Non-Violence v. Reid*, the defendant, Reid, owned the exclusive copyright for three-dimension-

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46 See Gilbert & Streeter, supra note 25, at 181 (noting that because *Peregrine* holds that security interests in proceeds from copyrighted works must be recorded in the Copyright Office, one might also argue—though this result would be incorrect—that the Copyright Act preempts state law governing a security interest in the celluloid).


48 Id.

49 Importantly, this provision is in the same chapter as section 205(d), which governs priority disputes.

50 For example, in the motion picture industry, the laboratory often has a security interest in, and possession of, the negative of a particular motion picture.

al reproductions of a sculpture. Plaintiff CCNV owned and possessed the tangible sculpture. Reid desired to make a mold of the sculpture to capitalize on his exclusive three-dimensional reproduction rights, but CCNV refused to give him access. Without much discussion and citing only cases involving easements to real property, the court held that Reid did not have to create an original work of art to exploit his copyright. Instead, Reid had a limited possessory right—in the nature of an implied easement of necessity—to cause a master mold to be made of the sculpture.  

By analogy, a trustee-in-bankruptcy who has priority in a copyright but not in the tangible property arguably could have a similar right of access to the tangible property. Yet, the brief opinion in CCNV rests on virtually no authority. Moreover, in Peregrine, the secured creditor is in a somewhat stronger equitable position than the owner of the sculpture in CCNV. The right to exclude may be the only thing that gives value to the secured creditor's interest in the tangible property. This is not the case in CCNV in which the sculpture had value independent of any right to exclude. The point is that the scope of rights in tangible property could, as a practical matter, have a significant impact on a court's determination of conflicting priorities. Neither Peregrine nor AEG considered this issue.

B. SECURED INTERESTS IN THE PROCEEDS DERIVED FROM COPYRIGHTS

One of the most interesting aspects of Peregrine is Judge Kozinski's conclusion that the creditor's security interest in the proceeds derived from the debtor's film library (i.e., in the accounts receivable derived from exploitation of the copyrights) constituted the type of security interest, which as a matter of federal preemption, is subject to recordation in the Copyright Office. It has been noted that this conclusion is questionable, since "income" from a copyright is not, under section 106 of the Copyright Act, one

61 Id. at ¶ 25,027.
of the exclusive rights granted to a copyright owner. Therefore, one could persuasively argue that Peregrine's holding is incorrect in this regard, and that state law appropriately governs recordation and priorities of security interests in accounts receivable derived from exploitation of the copyright.

Indeed, the practical considerations behind a nationwide system of copyright recordation do not necessarily apply to security interests in proceeds derived from the copyright. Given the diverse entities and varied rights at issue, a creditor taking a security interest in the copyright itself must rely on a "work-based" system of recordation. The same does not apply to proceeds derived from those interests. Because such proceeds are ordinarily paid to the debtor (who thus has possession of the proceeds), there is usually no need to conduct duplicative searches of state indices. Rather, the Uniform Commercial Code's debtor-based system of recordation seems to serve the interest of the secured creditor, whose main concern is that revenues received by the debtor are unencumbered.

Nonetheless, motion picture financiers can make a strong counter-argument that Peregrine correctly decided the issue. A security interest in the copyright of a film may not be worth much as collateral if the debtor has granted another party a security interest in the proceeds derived from distribution of the film. Therefore, a work-based system of recordation and indexing as it relates to proceeds from a copyright could arguably serve the interests of certainty in connection with copyrights as collateral.

In short, Peregrine's application of the federal preemption doctrine may be overbroad in connection with security interests in proceeds derived from copyright. The statutory language affords less support for its decision as to preemption, and the policies favoring one system over another are not clear.

CONCLUSION

Professor Heald's article is laudable in its attempt to provide guidance to courts in practical situations involving disagreements about priority disputes over intellectual property collateral. More
broadly, Heald focuses on an issue too often ignored in copyright literature, namely, the interrelationship between state and federal law.

The recent controversy over the *Peregrine* decision, however, has resulted in negative reactions that, upon analysis, are often difficult to explain in light of the apparent preference for a federalized system of recordation or priority by parties actually involved in commercial transactions. To most copyright practitioners, *Peregrine* was neither unexpected nor incorrect. Given recent proposals that would radically change the current system, a debate on the issue of priority and recordation, to which Professor Heald's Article makes a notable contribution, is certainly warranted. One only hopes that such a debate will take place before any new legislation is precipitously enacted.