PERFECTION OF SECURITY INTERESTS IN COPYRIGHTS: THE *PEREGRINE* EFFECT ON THE ORION PICTURES PLAN OF REORGANIZATION*

I. INTRODUCTION

In a case of apparent first impression, the district court for the Central District of California recently held in *National Peregrine, Inc. v. Capitol Federal Savings & Loan Association of Denver* (*In re* Peregrine Entertainment, Ltd.)[1] that recordation in the United States Copyright Office is the exclusive means for perfecting a security interest in a copyrighted work.[2] The court ruled that a security interest in a copyrighted work cannot be perfected by a state filing under the Uniform Commercial Code ("UCC").[3]

The court's opinion also suggests that a security interest in accounts receivable,[4] which are contracts for the future payment of licensing of films, can be perfected only by Copyright Office recordation.[5] The result burdens financial institutions that extend loans secured by receivables generated from the commercial exploitation of copyrighted works (e.g., a library of films or a catalog of computer software) because the recording requirements under copyright are considerably more cumbersome than UCC filings. In response, Senator DeConcini (D-Ariz.) and Representative Hughes (D-N.J.) introduced in February 1993 the Copyright Reform Act of 1993 for the purpose, *inter alia*, of modifying recordation and registration requirements.[6] As Representative Hughes remarked upon introducing the bill, it represents the

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1 116 B.R. 194 (C.D.Cal. 1990) [hereinafter *In re* Peregrine].

2 *Id.*

3 *Id.*

4 Accounts receivable in the motion picture industry consist primarily of trade receivables due from film distribution including theatrical, home video, basic cable and pay television, network, television syndication, and other licensing sources. *See* Orion Pictures Corporation's Disclosure Statement for Debtors' Third Amended Joint Consolidated Plan of Reorganization, at BF-12, *In re* Orion Pictures Corp., Ch. 11 Case No. 91 B 15635 [hereinafter Disclosure Statement].

5 *In re* Peregrine, 116 B.R. 194.

6 S. 373/H.R. REP. No. 897, 103d Cong., 1st Sess. (1993). The identical bills sought to amend title 17 of the United States Code and were introduced on February 16, 1993. Senator DeConcini is the Chairman of the Subcommittee on Patents, Copyrights

most recent legislative attempt to reverse the *Peregrine* decision and alleviate the "considerable amount of time and expense [that] is required in order to comply with [the] decision."[7]

Conventionally in the motion picture industry, loans made to finance the creation of copyrightable works are secured by what are, in effect, mortgages of the copyrights to those as-yet unproduced works themselves.[8] Additionally, the common industry practice is to register the copyright in new motion pictures only when they are substantially complete and ready for release.[9] Not only would early registration pose various technical difficulties, but it would cover only part of the ultimate content of the film in question and, as a result, would probably necessitate subsequent re-registration.[10] But under section 205(c) of the Copyright Act (the "Act"), no security interest can be perfected under federal law until the copyright in the work to which it pertains has been *registered*.[11] If the federal scheme is exclusive of state law, this means that in practice, a film industry lender may find it difficult to perfect its security interest until some time after the loan is disbursed, during which period the copyright owner may make conflicting transfers to other bona fide purchasers.[12]

The following hypothetical serves to point out this potentially serious flaw in the federal recordation scheme. Assume film producer *P* plans to produce a movie entitled *Over the Rainbow*. To finance production, he[13] borrows from *A* and gives the copyright as collateral. *A* immediately and properly records with the Copyright Office the security agreement, which identifies the

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and Trademarks, and Representative Hughes is the Chairman of the Subcommittee on Intellectual Property and Judicial Administration.

7 139 Cong. Rec. E.338 (daily ed. Feb. 16, 1993). Representative Hughes commented upon introducing the legislation that the *Peregrine* decision has "turned a relatively simple business transaction into a nightmare for businesses and lenders. Moreover, given that a number of lenders have, in the past, only made UCC filings, there is considerable uncertainty about past transactions." *Id.*

Moreover, Senator DeConcini remarked that the *Peregrine* decision has "resulted in a 50 percent increase in the recordation of transfers with the Copyright Office and has caused considerable administrative burdens for business." 139 Cong. Rec. S.1618 (daily ed. Feb. 16, 1993).

8 CRAIG JOYCE ET AL., COPYRIGHT LAW, § 4.02, at 298 (1991).

9 *Id.*

10 *Id.*

11 17 U.S.C. § 205(c)(1) (1988), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2857 ("after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title or *registration* number of the work") (emphasis added).

12 *See* Note, *Transfers of Copyrights for Security Under the New Copyright Act*, 88 YALE L.J. 125(1978)[hereinafter *Transfers of Copyrights*].

13 The use of any gender in this Note shall include the other gender, whenever appropriate.

movie-to-be by its title, *Over the Rainbow*. As production proceeds, *P* also borrows money from *B*, again giving the copyright as collateral. *B* is told that the movie is to be entitled *The Wizard of Oz*. *B* promptly and properly records the security agreement. When the movie is completed, *P* registers it under the title *The Wizard of Oz*. Since *A's* security agreement would not be revealed by a reasonable search under the title or registration number of the work, *A's* recordation does not give constructive notice, whereas *B's* recordation does. Therefore, *B* has priority over *A*.[14]

This Note analyzes the *Peregrine* court's holding that federal law relating to copyright transfer recordation preempts parallel methods of perfecting such security interests under state laws incorporating the UCC.[15] It will discuss some of *Peregrine's* possible implications for financial institutions, entertainment or software companies, and other entities that extend or obtain loans secured by interests in copyrighted works. The issue of deciding the proper way to perfect a security interest in copyrights was most recently raised in the Orion Pictures bankruptcy plan of reorganization[16] under Chapter 11 of the Bankruptcy Code (the "Code").[17] In the Orion case, the debtors carefully analyzed the documentation of the creditors' security interest, analyzed the relevant case law, and "determined that challenging the Banks' liens would likely result in costly and protracted litigation with an uncertain outcome."[18] This demonstrates that until the issue is authoritatively resolved, the *Peregrine* decision represents a potentially serious flaw in the federal recordation scheme. Moreover, the decision may also set undesirable precedents for present and future bankruptcy proceedings in the motion pictures industry.[19]

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[14] *Transfers of Copyrights*, *supra* note 12, at 131 n.31. According to the Copyright Act:

> As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice. . . .Otherwise the later transfer prevails if recorded first in such manner, and if taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.

17 U.S.C. § 205(d), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2857.

[15] JOYCE et al., *supra* note 8.

[16] A plan of reorganization represents a compromise and settlement reached among the debtors' principal creditor constituencies, most of which will relinquish, upon confirmation of the plan, potential legal and equitable claims in exchange for the treatment and certainty provided by the plan. *See* 11 U.S.C. § 1123(a)(5) (1988).

[17] 11 U.S.C. § 1101.

[18] *See* Disclosure Statement, *supra* note 4, at 47.

[19] Orion Pictures was not the only movie studio to experience financial turmoil in recent years. Despite producing such big hits like *Basic Instinct* and *Terminator*, Carolco Pictures, Inc. was pushed to the bankruptcy precipice in 1992, having lost almost $57 million for the first nine months of the year. Steve Ginsberg, *Hollywood Starts Year Slow*, LOS ANGELES BUSINESS JOURNAL, Dec. 21, 1992, at 18. In a related matter, Live En-

Part II will examine the *Peregrine* case and consider its implications. Part III will discuss the history of the Orion Pictures reorganization, one of the largest and most publicized reorganizations to date. Part IV will integrate the legal issues raised by *Peregrine* into the context of the Orion Pictures bankruptcy filing. Part V will discuss possible alternatives to the current complexities facing lenders seeking to perfect security interests in copyrights.

II. NATIONAL PEREGRINE: THE CASE

National Peregrine, Inc. ("NPI") was a Chapter 11 bankruptcy debtor-in-possession[20] whose principle assets were a library of copyrights, distribution rights, and licenses for about 145 films.[21] In obtaining a line of credit, NPI granted Capitol Federal Savings and Loan Association of Denver ("Capitol Savings") a security interest in all of NPI's assets, including general intangibles.[22] The collateral was described in both the security agreement and the UCC financing statements filed by Capitol Savings as "[a]ll inventory consisting of films and all accounts, contract rights, chattel paper, general intangibles, instruments, equipment, and documents related to such inventory, now owned or hereafter acquired by the [d]ebtor."[23] Capitol Savings

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tertainment, Inc., a video distribution company which is half-owned by Carolco, filed for Chapter 11 bankruptcy protection in February 1993. *Live Entertainment Files for Chapter 11*, REUTERS BUSINESS REPORT, Feb. 2, 1993, at 1.

20 Unless a trustee is appointed in the bankruptcy case, the debtor generally remains in possession of the property of the estate and continues to operate the business. The debtor-in-possession has all of the rights, powers, and duties of a trustee, except the right to compensation and the duty to investigate the debtor. 11 U.S.C. §§ 1107(a), 1108.

21 *In re* Peregrine, 116 B.R. at 197.

22 *Id.* at 197-98.

23 *Id.* The UCC financing statement describing the collateral included, but was not limited to:

> (i) all accounts, contract rights, chattel paper, instruments, equipment, general intangibles and other obligations of any kind whether now owned or hereafter acquired arising out of or in connection with the sale or lease of the films, and all rights whether now or hereafter existing in and to all security agreements, leases, invoices, claims, instruments, notes, drafts, acceptances, and other contracts and documents securing or otherwise relating to any such accounts, contract rights, chattel paper, instruments, general intangibles or obligations and other documents or computer tapes or disks related to any of the above;
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> (ii) all proceeds of any and all of the foregoing property, including cash and noncash proceeds, and, to the extent not otherwise included, all payments under insurance . . . or any indemnity, warranty or guaranty, payable by reason of loss or damage to or otherwise with respect to any of the foregoing property.

Id. n.3.

filed its financing statements in California, Colorado, and Utah,[24] but did not record its interest at the Copyright Office under the Copyright Act.[25]

After filing for protection under Chapter 11 of the Bankruptcy Code, NPI claimed that Capitol Savings' security interest was unperfected because it was not recorded in the United States Copyright Office.[26] Although the bankruptcy court was not persuaded by NPI's argument, the federal district court agreed, holding that the recordation provisions of the Copyright Act, rather than the filing provisions of state law, govern the perfection of security interests in copyrights. In essence, Judge Kozinski of the Ninth Circuit, sitting in designation,[27] answered the question of whether a security interest in a copyright is perfected by an appropriate filing with the Copyright Office or by a UCC-1 financing statement with the relevant secretary of state. By ruling Capitol Savings' security interest unperfected,[28] the federal court[29] diluted Capitol Savings' protection because "[t]he holder of an unperfected security interest . . . takes a greater risk by not . . . perfecting because an unperfected Article 9 security interest does not have priority over a subsequent judicial lien."[30]

A. *Implications for Financing Transactions*

The Copyright Act provides that "[a]ny transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office."[31] Under the Act, a " 'transfer' includes any 'mortgage' or 'hypothecation of a copyright,'[32] whether 'in whole or in part' " and "by any means of conveyance

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24 Apparently, Capitol Savings deemed it prudent to file in Utah since it was incorporated there, and California since it conducts much of its business in that state. Presumably, it filed in Colorado because its own headquarters are located in Denver.

25 116 B.R. at 198.

26 *Id.* at 194.

27 A circuit court judge may be "designated and assigned" to temporary duty in a district court within the circuit. 28 U.S.C.A. § 291(b), *as amended by* Act of Oct. 29, 1992, Pub. L. No. 102-572, 106 Stat. 4507.

28 Perfection of a security interest determines whether the security interest is effective against third parties. For example, suppose the debtor, after granting a security interest in collateral to *Creditor A*, either sells the collateral to *Buyer* or grants a security interest in the collateral to *Creditor B*. *Creditor A* will have priority over *Buyer* or *Creditor B* only if the security interest of *Creditor A* was perfected.

29 *In re* Peregrine, 116 B.R. at 208.

30 ROBERT L. JORDAN & WILLIAM D. WARREN, BANKRUPTCY, at 476 (1989). *See also* U.C.C. § 9-301(1)(b) (1978).

31 17 U.S.C. § 205(a).

32 *Id.* § 101. The term "hypothecation" refers to a pledge of property as security and "mortgage" refers to collateral for a debt. *See* BLACK'S LAW DICTIONARY 742-3, 1009-10 (6th ed. 1990).

or by operation of law."[33] In addition, the Copyright Office has defined a document pertaining to a copyright as one that has a direct or indirect relationship to the "existence, scope, duration, or identification of a copyright, or to the ownership, division, allocation, licensing, transfer, or exercise of rights under a copyright. That relationship may be past, present, future, or potential."[34] Likewise, since a copyright entitles the holder to "display the copyrighted work publicly,"[35] the *Peregrine* court noted that "an agreement creating a security interest in the receivables generated by a copyright"[36] may also be recorded in the Copyright Office.[37] In light of the above, the *Peregrine* case makes it clear that anyone taking a security interest in copyrighted works can only perfect such security interest by recording it in the Copyright Office. It is important to note, however, that this holding has no effect on how a creditor initially obtains a security interest in such assets.

The *Peregrine* case should prompt secured lenders, as well as borrowers who rely heavily upon their copyright assets for collateral, to comply with the recording procedures of the Copyright Act, which are different from the filing requirements of the UCC.[38]

B. *Judge Kozinski's Justification: Federal Law Preemption*

The scope of the Copyright Act's recording provisions, along with the unique federal interests they implicate, support the view that federal law preempts state methods for perfecting security interests in copyrights and related accounts receivable. The Copyright Act expressly does preempt state law with respect to the exclusive rights possessed by holders of copyrights under federal law.[39] However, Judge Kozinski noted that the preemption provision at section 301 of the Copyright Act was inapplicable because the issue in *Peregrine* was not the creation of exclusive rights under section 106,[40] but rather the fundamentally different question of their transfer, governed by separate provisions of the

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[33] 17 U.S.C. § 201(d)(1).

[34] 37 C.F.R. § 201.4(a)(2) (1988).

[35] 17 U.S.C. § 106(5).

[36] *In re* Peregrine, 116 B.R. at 199.

[37] For a discussion of the court's treatment of security interest perfection in accounts receivable, see infra note 172 and accompanying text.

[38] For a discussion of the different filing requirements, see *infra* notes 42-45 and accompanying text.

[39] 17 U.S.C. § 301(a) (1988), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2857.

[40] The exclusive rights listed in section 106 include the right to reproduce the copy-

Copyright Act.[41]

Judge Kozinski pointed out that section 205(a) of the Copyright Act establishes a uniform method for recording security interests in copyrights by providing that a secured creditor need only file in the Copyright Office to give all persons constructive notice of the facts in the recorded document.[42] Likewise, a third party need only search the Copyright Office's indices to determine if a copyright is encumbered.[43]

The court also noted the usefulness of a recording system that provides interested parties with a specific place to look in order to determine whether a property interest has been transferred or encumbered. "To the extent there are competing recordation schemes, this lessens the utility of each; when records are scattered in several filing units, potential creditors must conduct several searches before they can be sure that the property is not encumbered."[44] Judge Kozinski reasoned that the possibility that relevant jurisdictions may remain unsearched, "together with the expense and delay of conducting searches in a variety of jurisdictions, could hinder the purchase and sale of copyrights, frustrating Congress's policy that copyrights are readily transferable in commerce."[45]

The Ninth Circuit adopted a similar preemption rationale in *Danning v. Pacific Propeller, Inc.*,[46] a case that dealt with security interests in civil aircraft. According to the court in *Danning*, "[t]he predominant purpose of the statute was to provide one central place for the filing of [liens on aircraft] and thus eliminate the need, given the highly mobile nature of aircraft and their appurtenances, for the examination of State and County records."[47] Judge Kozinski observed that "[c]opyrights, even more than aircraft, lack a clear situs; tangible movable goods such as airplanes must always exist at some physical location; they may have a home base from which they operate or where they receive regular

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righted work, to distribute the work, to prepare derivative works, and to display or perform the work. *See* 17 U.S.C. § 106.

41 *In re* Peregrine, 116 B.R. at 199 n.6.

42 *Id.* at 200.

43 *Id.*

44 *Id.* (adopting the reasoning in Danning v. Pacific Propeller, Inc. (*In re* Holiday Airlines Corp.), 620 F.2d 731, 735-36 (9th Cir.) (holding that the Federal Aviation Act's provision for recording conveyances and the creation of liens and security interests in civil aircrafts, preempts state filing provisions), *cert. denied*, 449 U.S. 900 (1980)).

45 *In re* Peregrine, 116 B.R. at 200.

46 620 F.2d 731 (1980).

47 *Id.* at 735-36.

maintenance [but] the same cannot be said of intangibles."[48] By way of analogy, he reasoned that perfection must be achieved through a single, national registration scheme and not individual state filings.

Furthermore, the legislative history of the Copyright Act of 1976 suggests a congressional intent to preempt the UCC's filing requirements.[49] For example, the House report accompanying the Act suggests that copyright mortgages should be federally recorded.[50] As previously noted, a mortgage is a transfer of ownership under the Copyright Act.[51] Therefore, by implication, Congress intended federal copyright law to provide a system of filing security interests in copyrights.

C. *Copyright Priorities vs. Article 9 Priorities*

The *Peregrine* court went on to note that the Copyright Act establishes its own scheme for determining priority between conflicting transferees.[52] Under Article 9 of the UCC, priority between holders of conflicting security interests in intangibles is generally determined by the date of perfection.[53] In contrast, section 205(d) of the Copyright Act (as redesignated by the Berne Convention Implementation Act of 1988)[54] provides that the transfer that is executed first prevails, as long as it is recorded with the Copyright Office within one month after being executed in the United States, or two months after being executed elsewhere.[55] As such, the Copyright Act, unlike Article 9, permits the effect of recording to relate back as far as two months. For example, suppose that *A* assigns to *B* a copyright in December 1992,

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48 *In re* Peregrine, 116 B.R. at 201.

49 3 M. NIMMER, NIMMER ON COPYRIGHT § 10.05[A] (1988). Professor Nimmer states that "a persuasive argument . . . can be made . . . that by reason of [s]ections 201(d)(1), 204(a), 205(c) and 205(e) of the [Copyright] Act. . .Congress has preempted the field with respect to the form and recordation requirements applicable to copyright mortgages." *Id.*

50 *See* H.R. REP. No. 1476, 94th Cong., 2d Sess. 123-24 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5738-39.

51 *See supra* note 32 and accompanying text.

52 *In re* Peregrine, 116 B.R. at 201.

53 *See* U.C.C. § 9-312(5)(a) ("Conflicting security interests rank according to priority in time of filing or perfection").

54 See *infra* note 123 and accompanying text.

55 According to the Copyright Act:

> As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice under subsection (c), *within one month after its execution in the United States or within two months after its execution outside the United States*, or at any time before recordation in such manner of the later transfer.

17 U.S.C. § 205(d) (emphasis added).

and then in January 1993, conveys the same rights to *C*, who takes without actual knowledge of the prior transfer to *B*. Under the terms of section 205(d), the first transferee, *B*, will prevail if he records within one month after execution of the agreement (two months if the agreement was executed outside the country). Thus, if both *B* and *C* record in January, *B* will still prevail. When the one-month grace period expires, the two transferees become competitors in a race to record. If *B*, the first transferee, loses and *C* is the first to record, *C* rather than *B* becomes the owner of the copyright.[56]

Because the Copyright Act and Article 9 create different priority schemes, permitting filing under the UCC would "undermine the priority scheme established by Congress with respect to copyrights."[57] Hence, Judge Kozinski determined that such direct interference with the operation of federal law weighed heavily in favor of preemption.

> A recordation scheme best serves its purpose where interested parties can obtain notice of all encumbrances by referring to a single, precisely defined recordation system. The availability of parallel state recordation systems that could put parties on constructive notice as to encumbrances on copyrights would surely interfere with the effectiveness of the federal recordation scheme. Given the virtual absence of dual recordation schemes in our legal system, Congress cannot be presumed to have contemplated such a result. The court therefore concludes that any state recordation system pertaining to interests in copyrights would be preempted by the Copyright Act.[58]

Although Article 9 establishes a comprehensive scheme for regulating security interests in personal property and fixtures, Judge Kozinski observed that it is not "all-encompassing."[59] Under the "step-back" provision of section 9-104, Article 9 does not apply to "a security interest subject to any [federal statute] to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property."[60] Thus, he explained, when a national recording system exists, the UCC treats compliance with that system as equivalent to filing a financing statement under Article 9,[61] and a security

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56 *See* JOYCE, et al., *supra* note 8, at 297.
57 *In re* Peregrine, 116 B.R. at 201.
58 *Id.* at 201-02.
59 *Id.* at 202.
60 U.C.C. § 9-104 and official comment 1.
61 The UCC addresses the potential conflict between its provisions and the Copyright Act as follows:

interest in property subject to the statute or treaty can be perfected only through such compliance.[62]

Judge Kozinski determined that section 205(a) of the Copyright Act clearly established a national system for recording transfers of copyright interests and specified a place of filing different from that provided in Article 9.[63] Moreover, the court noted that the UCC drafters identified the Copyright Act as "establishing the type of national registration system that would trigger the . . . step-back provisions" delineated in sections 9-302(3) and (4) of the UCC.[64]

To the extent that they are germane to the issues presented here, the court rejected the rulings in *City Bank & Trust Co. v. Otto Fabric, Inc.*[65] and *In re* Transportation Design & Technology, Inc.[66] Those cases held that under the UCC, security interests in patents need not be recorded in the Patent and Trademark Office to be perfected as against lien creditors, because the federal statute governing patent assignments specifically provides for subsequent purchasers and mortgagees but not for lien holders.

> Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing. The applicant, patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United 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 . . . contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in copyrights from the provisions of this Article.

Id.

62 *In re* Peregrine, 116 B.R. at 202. According to the official commentary to U.C.C. § 9-302:

> Subsection (3) exempts from the filing provisions of this Article transactions as to which an adequate system of filing, state or federal, has been set up outside this Article and subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i.e., filing under this Article is not a permissible alternative).
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> . . .
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> Perfection of a security interest under a . . . federal statute of the type referred to in subsection (3) has all the consequences of perfection under the provisions of [Article Nine], Subsection (4).

U.C.C. § 9-302, official comments 8 & 9.

63 *In re* Peregrine, 116 B.R. at 202.

64 *Id.* at 203. According to the official commentary to U.C.C. § 9-302, "[e]xamples of the type of federal statute referred to in [U.C.C. § 9-302(3)(a)] are the provisions of [title 17] (copyrights)." U.C.C. § 9-302, official comment 8.

65 83 B.R. 780 (D. Kan. 1988).

66 48 B.R. 635 (Bankr. S.D. Cal. 1985) [hereinafter *In re* Transportation].

. . . .

> An assignment, grant or conveyance shall be void as against *any subsequent purchaser or mortgagee* for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.[67]

According to *In re* Transportation, because the Patent Act's priority scheme applies to "any subsequent purchaser or mortgagee for valuable consideration,"[68] it does not require recording in the Patent and Trademark Office to perfect against lien creditors. Similarly, *City Bank & Trust Co.* held that "the failure of the [Patent] statute to mention protection against lien creditors suggests that it is unnecessary to record an assignment or other conveyance with the Patent Office to protect the appellant's security interest against the trustee."[69]

According to Judge Kozinski, those cases misconstrued the plain language of UCC section 9-104, which indicates that it is ineffective where federal law governs the parties' rights. "Thus, when a federal statute provides for a national system of recordation or specifies a place of filing different from that in Article Nine, the methods of perfection specified in Article Nine are supplanted by that national system."[70] Whether the federal law also provides a priority scheme different from Article 9's scheme is a separate issue, the judge wrote, asserting that "[c]ompliance with a national registration scheme is necessary for perfection regardless of whether federal law governs priorities."[71]

The *Peregrine* court also distinguished two prominent trademark cases, *TR-3 Industries v. Capital Bank*[72] and *Roman Cleanser Co. v. National Acceptance Co.*,[73] both of which held that security interests in trademarks need not be perfected by recording in the Patent and Trademark Office. The *Peregrine* court reasoned that "unlike the Copyright Act, the Lanham Act's recordation provision refers only to 'assignments' and contains no provision for the registration, recordation or filing of instruments establishing security interests in trademarks."[74] On the other hand, "the Copyright Act authorizes the recordation of 'transfers' in the

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67 The Patent Act, 35 U.S.C. § 261 (1988) (emphasis added).
68 48 B.R. at 639.
69 83 B.R. at 782.
70 *In re* Peregrine, 116 B.R. at 204.
71 *Id.*
72 41 B.R. 128 (Bankr. C.D. Cal. 1984).
73 43 B.R. 940 (Bankr. E.D. Mich. 1984), *aff'd* 802 F.2d 207 (6th Cir. 1986).
74 116 B.R. at 204 n.14.

Copyright Office, and defines transfers as including 'mortgages,' 'hypothecation,' and, thus, security interests in copyrights."[75]

It must be noted that since section 205(d) of the Copyright Act does not expressly mention lien creditors,[76] the first question is whether a judicial lien is a transfer within the Copyright Act.[77] The *Peregrine* court concluded that it is.

> A judicial lien creditor is a creditor who has obtained a lien 'by judgment, levy, sequestration, or other legal or equitable process or proceeding'. . . .Such a creditor typically has the power to seize and sell property held by the debtor at the time of the creation of the lien in order to satisfy the judgment or, in the case of general intangibles such as copyrights, to collect the revenues generated by the intangible as they come due. . . . Thus, while the creation of a lien on a copyright may not give the creditor an immediate right to control the copyright, it amounts to a sufficient transfer of rights to come within the broad definition of transfer under the Copyright Act.[78]

The court rejected Capitol Savings' argument that "transfer" under section 205(d) of the Copyright Act refers only to consensual transfers, pointing out that the statute's definition specifically includes transfers by operation of law.[79] NPI, the debtor-in-possession, was therefore entitled to priority since it met the statutory good faith, notice, consideration, and recordation requirements of section 205 of the Copyright Act.

Having concluded that Capitol Savings should have recorded its security interest with the Copyright Office but had failed to do so, the court next assessed whether NPI, as a debtor-in-possession,[80] could subordinate Capitol Savings' interest and recover it for the benefit of the bankruptcy estate,[81] which includes "all legal or equitable interests of the debtor in property

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75 *Id.*

76 For a discussion of the priority schemes between conflicting transferees of interests in copyrights, see *supra* notes 52-56 and accompanying text.

77 *See, e.g.*, Note, *Creditors' Rights Issues in Copyright Law: Conflict and Resolution*, 11 BALTIMORE L.REV. 406 (1982).

78 116 B.R. at 205-06.

79 The Copyright Act's definition of transfer is very broad and specifically includes transfers "in whole or in part by any means of conveyance or by operation of law." 17 U.S.C. § 201(d)(1).

80 For a discussion of the rights granted to a debtor-in-possession, see *supra* note 20 and accompanying text. In addition, NPI, as debtor-in-possession, has the authority to set aside preferential or fraudulent transfers, as well as transfers otherwise voidable under applicable state or federal law. *See* 11 U.S.C. §§ 544, 547, 548 and *infra* notes 83, 90-91 and accompanying text.

81 116 B.R. at 204.

as of the commencement of the [bankruptcy] case."[82] Under the "strong-arm clause" of section 544(a) of the Bankruptcy Code,[83] the debtor-in-possession is given "every right and power state law confers upon one who has acquired a lien by legal or equitable proceedings."[84] Since the UCC provides that a judicial lien has priority over an unperfected security interest,[85] the court ruled that Capitol Savings' unperfected security interest in NPI's copyrights and the receivables they generated was "trumped by [the debtor's] hypothetical judicial lien."[86] As such, NPI could "avoid [Capitol Savings'] interest and preserve it for the benefit of the bankruptcy estate,"[87] thereby increasing the amount available for distribution to the unsecured creditors.

D. *In Support of* Peregrine: In re *AEG Acquisition Corporation*

Another recent Ninth Circuit[88] opinion that raised questions regarding the perfection of a security interest in copyrights is *AEG Acquisition Corporation v. Zenith Productions Ltd.* (*In re* AEG Acquisition Corp.).[89] In that case, the United States Bankruptcy Court for the Central District of California permitted the debtor-in-possession for a bankrupt film distributor to recover, as voidable preferences[90] and fraudulent transfers,[91] payments made for distribution rights in unregistered foreign films, because the

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82 11 U.S.C. § 541(a)(1).

83 11 U.S.C.§ 544(a)(1) provides:

> The [debtor-in-possession] shall have, as of the commencement of the case and without regard to any knowledge of the [debtor-in-possession] or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor of a simple contract could have obtained such a judicial lien, whether or not such a creditor exists.

84 *In re* Peregrine, 116 B.R. at 204.

85 *See* UCC § 9-301(1)(b)("an unperfected security interest is subordinate to the rights of . . .[a] person who becomes a lien creditor before the security interest is perfected").

86 *In re* Peregrine, 116 B.R. at 207.

87 *Id.*

88 Both *In re* Peregrine and *In re* AEG Acquisition Corp. were adjudicated in the Central District of California and are therefore not binding on the Southern District of New York, the Court in which the Orion Pictures bankruptcy case was pending.

89 127 B.R. 34 (Bankr. C.D. Cal. 1991).

90 A preference is any transfer of a debtor's interest in property to or for the benefit of a creditor, for or on account of an antecedent debt owed by the debtor, and made while the debtor is insolvent and within 90 days (or, in the case of an "insider," one year) prior to filing the bankruptcy petition that enables the transferee to receive more than he would receive in a liquidation case if the transfer had not been made. *See* 11 U.S.C. § 547(b).

91 A fraudulent transfer is one made with an intent to hinder, delay, or defraud creditors. *See* 11 U.S.C. § 548(a)(1).

creditor's security interest in the copyrights was not perfected.[92]

AEG Acquisition Corporation ("AEG") was a Chapter 11 debtor whose principal asset was a library of copyrights in more than 100 motion pictures.[93] In 1987, AEG's predecessor (Atlantic Entertainment Group, Inc.) obtained from Zenith Productions the distribution rights for three pictures: *Patty Hearst*, *For Queen and Country*, and *The Wolves of Willoughby Chase*.[94] When Atlantic failed to pay Zenith the guaranteed amounts under the agreements, the parties renegotiated the contracts, and Atlantic executed a confession of judgment[95] for $6 million.[96]

Kartes Video Communications, Inc. ("KVC") acquired Atlantic and renamed it AEG.[97] Zenith entered into a new agreement with KVC whereby AEG would reacquire the motion picture distribution rights for $6 million.[98] Although the contract called for a confession of judgment[99] in the amount of $6 million, it also required destruction of the judgment upon payment of all sums under the agreement.[100]

AEG also gave Zenith a security agreement in the motion pictures, and Zenith filed UCC-1 financing statements in California, Indiana, and New York.[101] Zenith recorded a copyright mortgage in the Copyright Office for each of the films and later obtained a copyright registration for *Patty Hearst* only.[102] Under its agreement, AEG paid Zenith $250,000 on April 12 and $1.81 million on May 10, 1989.[103] On July 28, 1989, AEG filed its Chapter 11 petition.[104] Subsequently, AEG filed an adversary proceeding against Zenith to recover the more than $2 million in payments made to Zenith.[105]

Following the rationale articulated by the *Peregrine* court, Judge Buffer noted in *In re* AEG Acquisition Corp. that under

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92 127 B.R. at 38.
93 *Id.* at 37.
94 *Id.*
95 A confession of judgment (a/k/a cognovit judgment) is a "[w]ritten authority of [a] debtor and his direction for entry of judgment against him in the event he shall default in payment. Such provision in a debt instrument . . . permits the creditor or his attorney on default to appear in court and confers judgment against the debtor." BLACK'S LAW DICTIONARY 259-60 (6th ed. 1990).
96 *In re* AEG Acquisition Corp., 127 B.R. at 37.
97 *Id.*
98 *Id.*
99 *See supra* note 95 and accompanying text.
100 127 B.R. at 37.
101 *Id.* at 38.
102 *Id.*
103 *Id.*
104 *Id.*
105 *Id.*

section 544(a) of the Bankruptcy Code, the debtor's hypothetical lien creditor status[106] entitles it to prevail over holders of unperfected security interests.[107] Thus, Zenith must have perfected its security interest in the three films in order to retain the payments under the agreement. Citing the *Peregrine* decision, the court pointed out that the Copyright Act preempts the UCC for security interests in films.[108]

Judge Buffer concluded that Zenith's security interest in the *Patty Hearst* film was valid.[109] He pointed out that the mortgage[110] was recorded in the Copyright Office on March 29, 1989, and 14 days later Zenith obtained copyright registration for the movie.[111]

> Perfection of a security interest in a motion picture, as in any copyright, requires two steps: the film must be registered with the United States Copyright Office, and the security interest must be recorded in the same office. Registration of a copyright is accomplished by the submission of an application to the copyright office together with a nominal filing fee and one or two copies of the work to be copy-righted.
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> . . . .
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> Recordation of a security interest is also accomplished through the Copyright Office. . . . The filing of a copyright mortgage with the United States Copyright Office constitutes perfection of the security interest as long as an underlying registration is also filed with the Office.[112]

Similarly, the legislative history of the Copyright Act suggests that the registration requirement was meant to facilitate title searches by allowing the searcher to follow the chain of title from the author,[113] and by relieving the searcher of the responsibility for looking beyond a single index.[114]

Furthermore, Zenith contended that registration of the two other films was not necessary to perfect its security interest because, as foreign films, they are governed by the Berne Conven-

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106 *See supra* notes 83-84 and accompanying text.
107 127 B.R. at 40.
108 *Id.*
109 *Id.*
110 *See supra* note 32 and accompanying text.
111 *In re* AEG Acquisition Corp., 127 B.R. at 41.
112 *Id. See also* 17 U.S.C. § 408(a) (1988), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2859.
113 HOUSE COMM. ON THE JUDICIARY, 89th Cong., 1st Sess., COPYRIGHT LAW REVISION (Comm. Print. 1965).
114 This purpose is not brought out in the legislative history of the Act, but it is implicit in the limitation of constructive notice to documents revealed by reasonable searches under the title index. *See* 17 U.S.C. § 205(c)(1).

tion Act[115] which contains no such requirement. One of the principal substantive provisions of the Berne Convention is its requirement that Convention authors enjoy the same protection in any member country as the nationals of that country.[116] The Convention also provides certain rights that are superior to national law, such as the right to copyright protection without complying with any formalities.[117] Thus, the *AEG* court noted that "[i]f this provision were applicable without restriction in the United States, Zenith might prevail in its argument that registration is not required as a condition for the perfection of a security interest in a foreign work."[118]

Under United States law, not all treaties are self-executing.[119] A self-executing treaty creates rights for the nationals of a country that is party to the convention without the implemention of domestic legislation.[120] On the other hand, a treaty that is not self-executing requires domestic legislation to create rights thereunder.[121] "Whether a particular treaty is self-executing or

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115 Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, *revised* Paris, July 24, 1971, 25 U.S.T. 1341, T.I.A.S. No. 7868, 828 U.N.T.S. 221 [hereinafter Berne Convention]. The text is reproduced in 4 M. NIMMER & D. NIMMER, NIMMER ON COPYRIGHT Appendix 27 (1989).

On March 1, 1989, the United States became a member of the Berne Convention. The Berne Convention is a multilateral international copyright treaty that offers a higher level of copyright protection to authors than any other multilateral treaty to which the United States has been a party. The Convention was signed originally at Berne in 1886, revised at Berlin in 1908, Rome in 1928, Brussels in 1948, Stockholm in 1967, and further revised in Paris in 1971 and amended in 1979. This Note, unless otherwise stated, will refer to the 1971 Paris Act of the Berne Convention. *See* Motyka, Note, *U.S. Participation in the Berne Convention and High Technology*, 39 ASCAP COPYRIGHT L. SYMP. 107 (1992); Nimmer, *The Impact of Berne on United States Copyright Law*, 8 CARDOZO ARTS & ENT. L.J. 27 n.4 (1989).

116 The Berne Convention states that:

> Authors shall enjoy, in respect of works for which they are protected under this Convention, in countries of the Union other than the country of origin, the rights which their respective laws do now or may hereafter grant to their nationals, as well as the rights specially granted by this convention.

Berne Convention, art. 5(1).

117 The Berne Convention states that:

> The enjoyment and the exercise of these rights shall not be subject to any formality; such enjoyment and such exercise shall be independent of the existence of protection in the country of origin of the work. Consequently, apart from the provisions of this Convention the extent of protection, as well as the means of redress afforded to the author to protect his right, shall be governed exclusively by the laws of the country where protection is claimed.

Id., art. 5(2).

118 127 B.R. at 42.

119 *Id.*

120 RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 111 (1987). For example, if the Berne Convention was a self-executing treaty, as soon as it had been signed by the President and ratified by the Senate, it would have automatically become part of United States Copyright Law. *See* Motyka, *supra* note 115, at 120.

121 Motyka, *supra* note 115, at 120.

not typically turns on the domestic law of the particular state party, and may vary from one state party to another."[122]

When the United States ratified the Berne Convention, the Senate determined that the treaty should not be self-executing and Congress enacted implementing legislation to give it effect.[123] Thus, Judge Bufford noted that the Berne Convention created rights in United States law only to the extent that it is implemented through domestic legislation. "The language of the convention alone does not excuse Zenith from complying with United States law to preserve its rights as a secured creditor in the foreign films . . . at issue, except to the extent that internal United States law so provides."[124]

Ultimately, the court held that Zenith was required to comply with domestic United States law to perfect its security interest in these films. "Since Zenith did not register the underlying foreign films, third parties were not put on notice of the copyright mortgages for the foreign films, and Zenith's interests remained unperfected."[125] In sum, the court awarded a partial summary judgment for Zenith with respect to the domestic film and for AEG with respect to the foreign films.

III. THE HISTORY OF *IN RE* ORION PICTURES

On December 11, 1991, Orion Pictures Corporation ("Orion") filed a voluntary petition[126] under Chapter 11 of the Bankruptcy Code.[127] Prior to the filing date, the debtors[128] were

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122 *In re* AEG Acquisition Corp., 127 B.R. at 42.

123 Berne Convention Implementation Act of 1988, Pub. L. No. 100-568, 102 Stat. 2853 (codified at 17 U.S.C. §§ 101, 104, 116, 301, 401-02, 404-08, 801 (1988)). "The Convention for the Protection of Literary and Artistic Works, signed at Berne, Switzerland, on September 9, 1886, and all acts, protocols, and revisions thereto . . . are not self-executing under the Constitution and laws of the United States." *Id.* § 2(1).

124 *In re* AEG Acquisition Corp., 127 B.R. at 42.

125 *Id.*

126 Pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code, the debtors continue to retain Orion's property and manage its business as a debtor-in-possession. *See* 11 U.S.C. §§ 1107(a) and 1108.

127 The Orion Pictures case was pending in the United States Bankruptcy Court, Southern District of New York, before the Honorable Chief Judge Burton R. Lifland. On Oct. 20, 1992, Judge Lifland entered an order confirming Orion's plan of reorganization. *See infra* note 165.

128 "Debtors" means, collectively, the following corporations, as debtors and debtors-in-possession: Orion Pictures Corporation; American Detectives Productions, Inc.; American International Pictures, Inc.; Arnold Productions, Inc.; Barrington Productions, Inc.; Brighton Productions, Inc.; Century Towers Productions, Inc.; Commonwealth Productions, Inc.; Dartford Productions, Inc.; Distribution Italy Holdings, Inc.; Donna Music Publications; Dutch Apple Enterprises, Inc.; 1875 Towers, Inc.; F.P. Productions; Heatter-Quigley, Inc.; Justice Productions, Inc.; Mob Productions, Inc.; Musicways, Inc.; OPC Distribution Europe, Inc.; OPC Music Publishing, Inc.; Orion Animation, Inc.; Orion Home Entertainment Corporation; Orion Music Publishing, Inc.;

engaged primarily in the financing, production, and distribution of motion pictures for the worldwide theatrical market, including distribution of motion pictures financed and produced by others.[129] The debtors also distributed motion pictures to the worldwide home video, free television, cable, and pay television markets.[130] Until May 31, 1991, the debtors were also engaged in the financing, production, and distribution of made-for-television product, including series, related pilots, motion pictures, mini-series, and first-run programming produced for syndication in the domestic television marketplace.[131] The debtors' expansive film library included in excess of 750 previously released theatrical and television motion pictures, television series, and other television programs.[132] At the filing date, their library also included twelve full-length motion pictures that were substantially complete but had not yet been released theatrically, two of which were released domestically in March 1992.[133] Some of the more successful recent motion pictures included in the film library are *Dances With Wolves* and *The Silence Of The Lambs*, both of which grossed more than $150 million at the box office and are substantial hits on video.[134] Further, Orion is the source of some of the most critically acclaimed films of the 1980s, including *Platoon*, *Amadeus*, *Bull Durham*, *Robocop,* and several of Woody Allen's films including *Hannah and Her Sisters.*[135] Moreover, directors have often hailed the studio, formed in 1978 by veteran executives of the United Artists studio,[136] for its willingness to "take chances

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Orion Pictures Distribution Corporation; Orion Records, Inc.; Orion Television, Inc.; Orion TV Broadcasting Corporation; Orion TV Broadcasting of Syracuse, Inc.; Orion TV Productions, Inc.; Pancho Productions, Inc.; Parker Kane Productions, Inc.; Publishers Distributing Corporation; Purdue Productions, Inc.; Tennessee Productions, Inc.; Tunes Productions, Inc.; Western Television Holding, Inc.; Wetherly Productions, Inc.; and Whattley Productions, Inc. *See* Disclosure Statement, *supra* note 4, at A-4, 5.

Additionally, the debtors' Chapter 11 cases were consolidated for procedural purposes only and were jointly administered pursuant to an order of the court. *See* Disclosure Statement, *supra* note 4, at 1.

129 *See* Motion for Order Authorizing Assumption of Distribution License Agreement, Jan. 6, 1992, at 2, *In re* Orion Pictures Corp., Ch. 11 Case No. 91 B 15635.

130 *Id.*

131 *Id.* at 2-3.

132 *Id.* at 3.

133 *See* Disclosure Statement, *supra* note 4, at 47.

134 Paul Sweeting, *Orion Pictures Files for Chapter 11 Protection*, BILLBOARD, Dec. 12, 1991, at 10.

135 Dave McNary, *Orion Pictures Files for Bankruptcy*, UPI, Dec. 11, 1991, at 1, *available in* LEXIS, Nexis library, UPI file.

136 Orion was founded by Arthur Krim, one of the executives who had rescued United Artists in the early 1950s. "In an industry marked by animosity between the 'talent'—the creators and developers of films—and the 'suits'—'the executives who run the studios'—Krim and his management team were admired for backing long-shot films . . .

on offbeat projects and not interfere during production."[137]

A. *Events Leading to the Bankruptcy Filing*

How did this apparent powerhouse in the movie industry fall prey to the clutches of bankruptcy protection? The answer lies in Orion's business practices, coupled with the general economic hardship of the industry. In recent years, Orion attempted to recover the cost of its movie projects from various licensing agreements it had in several markets[138] and the expected revenue contribution of its home video unit. During that period, however, most of Orion's films failed to meet preliminary expectations in the domestic market.[139] For example, during the fiscal year 1990, only one of Orion's films exceeded $10 million in worldwide theatrical film rentals.[140] Such lackluster performance caused significant outflows of cash as the earnings from domestic theatrical film rentals failed to recover print and advertising costs.[141] Combined with disappointing domestic home video results, this created a drain on Orion's cash resources.[142] In addition, the "costs of an expanding television production division and ever-increasing overhead, marketing and distribution costs and debt service costs, placed the debtors under enormous financial pressure, exhausting their credit lines and draining their available cash reserves."[143]

Orion's resulting liquidity problems began to surface in the first half of fiscal 1991.[144] At that time, Orion released or planned to release a large number of films having well-known stars and exceeding the average cost of Orion's films over the previous two-year period.[145] Generally, Orion paid for these films as they were delivered during this period, which required

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which became critical and commercial successes." John Lippman, *Orion Files for Bankruptcy Protection*, L.A. TIMES, Dec. 12, 1991, at A1.

137 McNary, *supra* note 135, at 1.

138 In the past, the debtors distributed motion pictures to theaters through the local offices of major motion picture companies and through leading local independent subdistributors, pursuant to agreements granting them exclusive distribution rights in designated territories for limited time periods with respect to specified motion pictures. *See* Disclosure Statement, *supra* note 4, at 29.

139 *Id.* at 32.

140 *Id.*

141 *Id.*

142 *Id.*

143 *See* Affidavit of William Bernstein, President and Chief Executive Officer of Orion Pictures Corporation, Dec. 11, 1991, at C10, *In re* Orion Pictures Corp., Ch. 11 Case No. 91 B 15635 [hereinafter Bernstein Affidavit].

144 *Id.* at C13.

145 *See* Disclosure Statement, *supra* note 4, at 32.

significant amounts of cash.[146] As a result, despite the success of several Academy Award-winning motion pictures, Orion was placed under enormous financial pressure by the economically disappointing motion picture releases during fiscal 1990 and part of fiscal 1991.[147] "Despite the enormous success . . . of many of [the company's] films, many of [Orion's] releases during the prior two year period have been economically disappointing."[148] Coupled with this strain were the costs of an expanding television production division and increasing overhead and debt service costs.[149] These factors combined to exhaust Orion's credit lines and to drain its available cash reserves.[150]

During the months preceding the filing date, the debtors' financial difficulties escalated.[151] In addition to being in default under its bond obligations, the debtors experienced difficulty in paying their trade obligations on a timely basis.[152] Moreover, Orion had fully utilized their $300 million line of credit provided by their banks,[153] and, pursuant to its Credit Agreement,[154] was required to make a $50 million principal amortization payment on August 31, 1991.[155] As a result of the debtors' liquidity problems, however, Orion defaulted on its obligations to make such payment.[156] Consequently, the debtors sought relief under Chapter 11 of the Bankruptcy Code as a means of "successfully and expeditiously reorganizing their financial affairs."[157] Orion's

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146 *Id.*

147 The studio's problems began to deepen when it hit a drought that included such flops as *She Devil, Valmont,* and *Great Balls of Fire.* Despite the financial success of *Silence of the Lambs,* which grossed more than $130 million in domestic ticket sales, Orion's next major releases, including *Bill & Ted's Bogus Journey* and *Little Man Tate,* "performed only adequately at the box office." *See* McNary, *supra* note 135, at 1.

148 Sweeting, *supra* note 134, at 10.

149 *See* Disclosure Statement, *supra* note 4, at 32.

150 *Id.*

151 In its bankruptcy filing with the court, Orion listed total assets of just over $1 billion and total liabilities of $973 million. *See* Sweeting, *supra* note 134, at 10.

152 In addition to its bondholder debt, Orion was carrying at the time of its petition approximately $70-80 million in unsecured trade debt, mostly to vendors, profit participants in its films, and creative guilds in the form of residual payments. *Id.*

153 "Banks" means Chemical Bank (formerly Manufacturers Hanover Trust Company); The Bank of Nova Scotia; Kansallis-Osake-Pankki; Continental Bank N.A.; National Bank of Canada; Bank of America National Trust and Savings Association; The Bank of California; Union Bank; National Westminster Bank; and any successors and assigns thereto. *See* Disclosure Statement, *supra* note 4, at A3.

154 "Credit Agreement" refers to the Second Amended and Restated Credit Agreement dated as of July 27, 1990, between Orion Pictures Corporation and Manufacturers Hanover Trust Company, as Agent, and the lenders who are parties thereto. *See* Bernstein Affidavit, *supra* note 143, at C11.

155 *Id.* at C13.

156 See Disclosure Statement, *supra* note 4, at BF-15 outlining the Consolidated Financial Statements of Orion and its subsidiaries at Feb. 29, 1992, and Feb. 28, 1991.

157 *See* Bernstein Affidavit, *supra* note 143, at C13.

Chief Executive Officer and President, William Bernstein, noted that the filing "was triggered by the breakdown of discussions with . . . bondholders about restructuring [Orion's] debt and recapitalizing the company."[158]

Since the filing date, the debtors' financial and other resources continued to decline.[159] Production operations essentially curtailed because of the debtors' inability to finance production of new films.[160] New product for distribution was limited to the ten unreleased films mentioned above.[161] To conserve resources, the debtors confined expenditures to those operating, post-production, and distribution and marketing costs that were necessary to preserve and maintain going-concern value.[162] In light of their financial condition, the debtors implemented a planned reduction in their workforce.[163] Because of the nature of their business, the debtors believed that prolonged operations in Chapter 11 would likely yield continued deterioration in the value of their assets and business operations.[164] Therefore, it was in their best interests to emerge expeditiously from Chapter 11 proceedings and receive confirmation of their plan of reorganization.[165]

IV. LEGAL ISSUES RAISED IN THE ORION PICTURES FILING

One of the most interesting legal issues related to the Orion filing was lien perfection for creditors claiming secured status. In particular, the holdings in *In re* Peregrine and *In re* AEG Acquisi-

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158 *See* Sweeting, *supra* note 134, at 10.

159 *See* Disclosure Statement, *supra* note 4, at 35.

160 *Id.*

161 *Id.*

162 *Id.*

163 The debtors have reduced their workforce from approximately 515 at the filing date to approximately 200 by the end of June 1992. *Id.* at 1.

164 The debtors believed that the protection afforded by Chapter 11 of the Bankruptcy Code would

> enable them to quickly rehabilitate their businesses, implement a viable business plan and consummate a plan of reorganization that would . . . provide for the equitable treatment of all claims and interests, preserve the value of [their] assets for the benefit of [their] creditors, shareholders and employees and facilitate the reorganization . . . as viable and profitable business enterprises.

See Bernstein Affidavit, *supra* note 143, at C13-14.

165 On October 20, 1992, Federal Bankruptcy Court Judge Burton R. Lifland entered an order confirming Orion's plan of reorganization. The plan was approved by a strong majority of the company's creditors. Pursuant to the agreement, bondholders received 49 percent of the equity of the reorganized company, and the Metromedia Company (Orion's largest shareholder) consented to reduce its stake from approximately 70 percent to 50.1 percent. In addition, Orion infused about $15 million in cash. *See Court Approves Orion Pictures' Reorganization Plan*, N.Y. TIMES, Oct. 21, 1992, at D4.

tion Corp. raised questions regarding the proper way to perfect a security interest in copyrights and account for distribution proceeds generated from the copyrights. In addition, these cases highlight the potential pitfalls for unwary lenders and the need to clarify the law in this area, while perhaps in some instances bringing the law in line with current standard commercial practices.

The secured lenders, primarily the consortium of banks, informed the debtors that prior to the *Peregrine* and *AEG* decisions, the customary practice for perfecting security interests in film copyrights was to file financing statements under the UCC and, where possible, to file with the Copyright Office. The banks in the Orion Pictures bankruptcy filing asserted not only that they filed financing statements under the UCC that covered substantially all the debtors' assets other than real property and fixtures, including all of the debtors' films, copyrights, and related proceeds, but also that they recorded with the Copyright Office their security interest in substantially all of the debtors' films, other than the 12 films that were unreleased prior to the filing date.

The banks maintained that they could not record a security interest in those 12 films with the Copyright Office because the debtors had not yet obtained copyright registration for them. Nevertheless, based upon the decisions cited above and notwithstanding the banks' UCC filings, questions arose regarding the perfection of the banks' liens not only in the 12 unreleased films, films against which the banks filed in the Copyright Office within the 90-day preference period under the Bankruptcy Code, but also in certain foreign rights and revenues.

As copyrights are considered personal property (general intangibles for the purposes of the UCC), security interests in them appear, at first blush, to be governed by the UCC. Notwithstanding the coverage of general intangibles in the UCC, those Code provisions do not apply where the recordation of certain types of security interests have been provided for on a federal register.[166] Moreover, since the inception of the UCC and despite the *Peregrine* and *AEG* rulings, there appears no definitive answer as to whether the federal copyright laws preempt the UCC with regard to the perfection of priority of security interests in such intellectual property.

Relying solely on the current federal system does not solve the lender's problems. The Copyright Act currently requires that in order to record a security interest in a copyright, a creditor

166 *See* U.C.C. §§ 9-104(a) and 9-106, official comment.

must "specifically [identify] the work to which it pertains, so that after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title registration number of the work."[167] That procedure is in stark contrast to the system employed under the UCC and results in significant disadvantages when compared to the UCC system.

Under the Copyright Act, for example, lenders are unable to conduct blanket searches to determine if the assets of a potential borrower are free of liens (searches must be undertaken against each copyright) and lenders are dependent upon their borrowers to inform them of each new copyright created (blanket and after-acquired liens are not provided for under the Copyright Act).[168] These two procedural aspects of filing under the Copyright Act place a lender at a significant disadvantage in knowing whether its security interest is and remains perfected, and whether its security interest has priority over the interests of other creditors.

In any case, a lender is at risk that a bankruptcy court might void the lender's perfected security interest in the new copyright as a preference pursuant to section 547 of the Bankruptcy Code.[169] On the other hand, the lender might attempt to argue that the new copyright was merely proceeds of the old copyright and thus it was continually perfected under the UCC,[170] or that the rules of accessions and commingled products apply so that "if the federal statute contained no relevant provision, this Article could be looked to for an answer."[171] However, there is no assurance that a court would rule in favor of a lender who advanced these positions. Although section 9-104 of the UCC steps back from governing perfection only to the extent that the Copyright Act governs the area, it is simply unclear whether a court faced with this issue will turn to section 9-104 of the UCC and rely on its provisions relating to proceeds, accessions, or commingled products. Instead, a court might rely on copyright principles to resolve the issue. Consequently, by mandating where to file to perfect a security interest in copyrights, the *Peregrine* court merely added to the overall uncertainty.

The *Peregrine* opinion, however, did not stop with the issue of

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167 17 U.S.C. § 205(c).

168 *See infra* notes 178-180 and accompanying text.

169 *See supra* note 90 and accompanying text.

170 U.C.C. § 9-306(3)(b) (a security interest in proceeds remains perfected if "a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds"). *See also* U.C.C. § 9-306(2)("a security interest . . . continues in any identifiable proceeds including collections received by the debtor").

171 *See* U.C.C. § 9-104, official comment 1.

how to perfect a security interest in copyrights; its holding went even further. The court also held that the Copyright Act preempts the UCC with respect to perfecting a security interest in a debtor's accounts receivable derived from the copyrights. The court's holding noted:

> [A]ny state recordation system pertaining to interests in copyrights was preempted by [the] Copyright Act, so security interest[s] in copyright could be perfected only by appropriate filing with United States Copyright Office and not by filing of UCC-1 financing statement with relevant Secretary of State, and creditor's security interest in copyrights of films in debtor's library and *receivables* generated therefrom was accordingly unperfected.[172]

Clearly, the *Peregrine* court went beyond addressing copyrighted works by holding that Copyright Office recordation is also necessary to perfect a security interest in receivables from a copyrighted work. Unfortunately, the court made this statement without distinguishing between a security interest in receivables and the underlying asset with which the flow of funds is associated. Therefore, it is difficult to evaluate the implications of *Peregrine* for security interests in assets other than copyrighted works themselves. As a result, this holding adds even more uncertainty for lenders considering extending credit to borrowers where the main source of collateral is the entity's accounts receivable derived from copyrights. Consequently, prudent lenders who are faced with the dilemma may choose to search and file at both the state and federal levels.

V. CONSTRUCTIVE SOLUTIONS

Because there is no clear guidance from governing federal case law, confusion exists about how to employ copyrights as collateral for a loan. Ever since the drafting of Article 9 of the UCC, there has been an uneasy co-existence between state law and federal law, both of which have some applicability when a debtor attempts to use a copyright to secure a loan. Although the *Peregrine* court discussed the issue, the fact remains that the way the two systems have interacted with one another was left unclear by the Article 9 drafters and has not been clarified by Congress. Complicating the uncertainty is the realization that the state and

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172 *In re* Peregrine, 116 B.R. at 194 (emphasis added).

federal systems are radically different from one another, both conceptually and as implemented.

In contrast to the standard UCC-1 financing statement commonly required by state authorities, there is no simple, standardized form for recording a copyright mortgage with the United States Copyright Office. Instead, the Copyright Office will record any transfer of copyright ownership (or any other document pertaining to a copyright) if such document satisfies the following requirements:

(1) the document must bear the actual signature or signatures of the person or persons who executed it. If a photocopy of the original signed document is submitted, it must be accompanied by a sworn or official certification which states that the attached reproduction is a true copy of the original signed document (such a certification might read "I certify under penalty of perjury under the laws of the United States of America that the foregoing is a true copy of the original document");

(2) the document must be complete by its own terms. If a document contains a reference to any schedule, appendix, exhibit addendum, or other material as being attached and made a part of it, it is recordable only if the attachment is submitted for recordation with the document;

(3) the document must be legible and capable of being reproduced in legible microfilmed copies; and

(4) the document must be submitted with the proper statutory recording fee.[173]

Upon being recorded, the Copyright Office returns the recorded document with a certificate of recordation. Such recordation gives all persons constructive notice of the facts stated in the recorded document if (1) the document, or material attached to it, specifically identifies each work to which it pertains so that, after the document is indexed by the Register of Copyrights, it will be revealed by a reasonable search under the title or registration number of the work, and (2) the registration has been made for the work referenced in the document.[174]

The UCC permits a secured party to perfect its security interest by filing a single financing statement that may use a generic collateral description to identify any category of a borrower's assets, such as all of its present and future copyrighted works.[175]

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[173] *See* 17 U.S.C. § 205(a).

[174] *See* 17 U.S.C. § 205(c).

[175] U.C.C. § 9-402(1) ("A financing statement is sufficient if it gives the names of the

By contrast, the Copyright Act only permits a secured party to perfect its security interest by recording appropriate transfer documents that must specifically identify each particular registered copyright by the registration number or the title of the work.[176] The need for such specificity alters customary perfection procedures in several ways.

First, although it is possible to list copyrighted works by title and/or registration number in an attachment to the transfer document being recorded, the compilation of such a list may be cumbersome (e.g., when collateral includes a large library of films or computer programs).

Second, parties to secured transactions involving copyrighted works must determine whether the copyrights are registered with the Copyright Office. Registration is not a prerequisite to copyright protection,[177] and some copyright owners may not register all of their copyrights. Therefore, it may be difficult, if not impossible, for a prudent lender to verify or even locate the recordation of appropriate security agreements.

Third, the Copyright Act has no provisions for "floating liens"[178] which are recognized by the UCC. Consequently, the after-acquired property clause of a UCC security agreement will not work to perfect a lien on a newly-acquired or newly-registered copyrighted work. A new transfer document must be recorded with the Copyright Office each time a debtor acquires a new copyrighted work, or substantially modifies or updates an existing copyrighted work. For instance, the *Peregrine* court cited the example of recording a security interest in a film library containing hundreds of individual filings.[179] As the contents of the film library change (e.g., films progress through the various stages of production), the creditor must make separate filings for each work added to or deleted from the library. On the other hand, a UCC filing "will provide a continuing, floating lien on assets of a particular type owned by the debtor, without the need

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debtor and secured party . . . and contains a statement indicating the types, or describing the items, of collateral").

176 *See* 17 U.S.C. § 205(c). *See also* text accompanying note 174 *supra*.

177 *See* 17 U.S.C. § 408(a) (1988), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2859 ("registration is not a condition of copyright protection"). However, registration remains important for some purposes. *See, e.g., id.* § 411(b), *as amended by* Act of Oct. 31, 1988, Pub. L. No. 100-568, 102 Stat. 2853, 2859 (registration is prerequisite to infringement suit").

178 *See* U.C.C. § 9-302. A security agreement may provide that any or all obligations covered by the security agreement are to secured by after-acquired collateral.

179 116 B.R. at 202 n.10.

for periodic updates."[180]

The Copyright Office's indexing and recording procedures also alter the manner in which a secured party may determine whether another party has priority. Under the UCC, financing statements are indexed by the name of the debtor.[181] By contrast, under the Copyright Act, records are indexed only by the titles and registration numbers of works, and not by the names of copyright owners and transferees.[182] Thus, it is not possible to conduct a lien search in the Copyright Office without using the titles or registration numbers for each of the copyrighted works serving as collateral. While there are certainly times when a prospective or existing borrower will be forthcoming with such information, there remains the possibility that either mistakes or explicit omissions will be made. Certainly, the lender's reliance on precise information is magnified.

Furthermore, there is a substantial delay between the effective date of a transfer of copyright ownership and the date on which such transfer can be recorded. Under the Copyright Act, a prior transfer prevails over a subsequent transfer, even though the subsequent transfer is recorded first, if the prior transfer is properly recorded within one month of executing the transfer document in the United States, or within two months of executing the transfer document elsewhere. By contrast, UCC financing statements generally "reach back" only ten days.[183] The obvious practical problems caused by the lengthy "reach back" of transfers recorded in the Copyright Office are exacerbated by the current filing and indexing backlog at the Copyright Office. By its own admission, the Copyright Office has "experienced a substantial increase in the number of documents submitted for recordation in the last few years, especially after the decision in . . . *Peregrine*."[184] On a positive note, the Copyright Office has admittedly "reassessed its practices concerning recordation of documents with a view to minimize delays in the recordation process."[185] Nevertheless, although a transfer document will be

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[180] *Id.* *See* U.C.C. § 9-204(1)("a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral").

[181] U.C.C. § 9-402.

[182] 17 U.S.C. § 205(c).

[183] *See* U.C.C. § 9-301 (allowing for a 10-day grace period during which time a secured party who files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral will take priority over the rights of a transferee or lien creditor).

[184] Announcement from Copyright Office, June 17, 1992 (copy on file with *Cardozo Arts & Entertainment Law Journal*).

[185] *Id.*

deemed "recorded" as of the date on which the Copyright Office receives the proper written document accompanied by the proper fee,[186] it may take another several months before such document is catalogued and appears on the relevant indices.

The *Peregrine* court acknowledged that recordation under the Copyright Act can be much less convenient and less useful than filing under the UCC.[187] Yet, the district court felt constrained to enforce the procedures that Congress had established. The court suggested that it was the responsibility of Congress, or possibly the Copyright Office, to change the procedures if the mechanics of recordation prove to burdensome. It appears that Congress has begun to respond. As Representative Hughes remarked,

> Congress' intent in enacting the relevant provisions in section 205 [of the Copyright Act] was to provide a system for ordering the priority between conflicting transfers, not to preempt state procedures for ensuring that a secured creditor's rights are protected. There is no reason the Federal and State systems cannot coexist.[188]

Based on the foregoing, it appears necessary to modify the current system so interested parties can more easily and timely determine who in fact has an ownership or lien interest in copyrights. Along these lines, secured creditors who finance the motion picture industry must be given adequate assurances, if not certainty, that they are perfected and will remain perfected in the property to which they are granted a security interest.

In light of the difficulties caused by either an exclusively state approach or an exclusively federal approach, a "mixed" approach should be endorsed. This method would require filings at the state level with identical filings on the form used for a UCC financing statement to be made at the Copyright Office. Under this hybrid approach, state filings would expressly govern priority interests as among lien creditors, secured creditors, and other third parties. The federal filings would establish priority among

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186 *See* 37 C.F.R. § 202.4 (1988):

> The effective date of registration for claims received by the Copyright Office . . . is the date on which the application, deposit, and . . . fee have all been received in the Copyright Office, provided the claim is later determined to be acceptable for registration by the Register of Copyrights and [the] fee is received in the Copyright Office.

Id.

187 116 B.R. at 202 n.10.

188 H.R. REP. No. 897, 103d Cong., 1st Sess. (1993). For further discussion of Representative Hughes' remarks, see *supra* note 7 and accompanying text.

purchasers and assignees for value. In addition to combining the place of filing, consideration should also be given to permitting secured parties to file a security interest prior to the federal registration of the property so that protection is afforded prior to the final product.

Unless copyrights are the only collateral in a particular secured transaction, it will remain necessary to file UCC financing statements as well to perfect the lien on the other collateral. In addition, even when copyright-related assets are the sole source of collateral, it will be prudent to file "back-up" UCC financing statements, since important ancillary rights or flows of funds may remain subject to the UCC despite *Peregrine*, and because other courts may not follow *Peregrine*.

It is recognized that a "mixed" approach will inevitably cause some confusion. For instance, dual filings and searches may be more costly and time consuming at first, at least until a new filing system at the federal level is created. Nevertheless, in order for any approach to succeed, and, for that matter, for the courts to correctly interpret the law, resulting legislation must make clear whether a security interest is perfected upon filing at the state level, the federal level, or both.

VI. Conclusion

Cautious lenders should consider whether under the circumstances of a particular transaction, it is worthwhile seeking to perfect security interests in copyrighted works by recording in the Copyright Office as well as by filing financing statements under the UCC. This will typically not be an easy decision because the current recordation procedures are burdensome. Nevertheless, until a legislative solution is devised, or further case law develops to clarify some of the ambiguities in the *Peregrine* decision, it is recommended that parties to secured transactions involving copyrighted works comply with both the filing requirements of the UCC and the recording requirements of the Copyright Act.

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