Copyrights As Collateral: Addressing the Reversion Risk

By Michael S. Poster

Loan structure must take into account potential reversions or terminations of copyright.

Intellectual property is frequently used as collateral in lending transactions. For certain borrowers, especially those in the entertainment industry, their copyrights are among their primary assets. However, many lenders are unaware of the termination and reversion rights that exist under the U.S. Copyright Act. Without taking these rights into account, lenders may structure loans with durations that go past reversion dates and with collateral that may cease to be owned by the borrower. This means that lenders may realize far too late that a significant piece of collateral may have suddenly disappeared, leaving them undercollateralized and causing borrowers to possibly be in default of loan covenants. This article outlines the primary termination rights that exist under the Copyright Act, including who may exercise these termination rights, when they may be exercised and the effects of termination.

There are four primary milestones in the life of a copyright that need to be considered: years 28, 35, 56 and 75.

Duration of Copyright Protection

Copyrights are often grouped into pre-1978 and post-1978 works. This is because the Copyright Act of 1976 ("the 1976 Act"), which became effective on January 1, 1978, fundamentally changed many of the laws concerning the ownership, maintenance, duration and control of copyrights. Before the 1976 Act, copyrighted works were governed by the Copyright Act of 1909 ("the 1909 Act"). The 1909 Act provided that copyrights were entitled to protection for 28 years; at the end of year 28, the author or owner needed to file a renewal application to maintain protection for an additional 28-year period (the so-called renewal term). The 1909 Act was later amended to extend the renewal term to 47 years, which was further extended to 67 years following passage of the Sonny Bono Copyright Term Extension Act in 1998. For post-1978 works, the term of copyright lasts for the life of the author, plus 70 years. One exception to this rule is copyrights created as "works made for hire" (discussed below), which have a fixed term of protection of 95 years from creation.

Works Made for Hire

These milestones—or any concerns regarding copyright reversions or terminations to individual authors—generally do not apply to works made for hire. Works made for hire (or "works for hire") are a class of copyrighted works that are created "by an employee within the scope of his or her employment" or are "specially ordered or commissioned" for use in certain classes of works.[1] Works made for hire are deemed to have been created from inception by the employer of the individual actually creating the work and are not treated as having been transferred or assigned by such individual. Therefore, these works are not subject to reversion to or termination by such individual. For a specially ordered or commissioned work to be considered to be a work made for hire, the individual creator and

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the employer *must* execute a written agreement to treat the work in this manner.[2] For this reason, many entertainment, media, software and other creative services companies require that employees and independent contractors enter into written work-for-hire agreements, and an important part of the legal due-diligence process regarding copyrights is confirming that the chain of title for the works includes appropriate work-for-hire agreements, where applicable.

Year 28

As discussed above, the 1909 Act provided that an author needed to file a renewal application to maintain protection for the renewal term. Failure to file the renewal application resulted in the work falling into the public domain. The 1909 Act was later amended to remove the requirement that a renewal application be filed for works first published beginning in 1964 (that is, works for which the initial 28-year period ended beginning in 1992). The 1976 Act eliminated the need for renewal filings on newly created copyrights. However, anyone valuing a catalog containing pre-1964 works (or works based on or derived from pre-1964 works) should check if renewal applications were timely filed to be sure the works, or underlying works, have not fallen into the public domain. This could be important if you are considering investing in a catalog that contains films based on books, plays, *etc.*, that have fallen into the public domain, because anyone can create new films based on the same underlying material, which could affect the market value of the earlier films.

A second important issue related to the 28-year milestone for pre-1978 works is whether the author died prior to the end of year 28. Under the 1909 Act, if an author granted the rights in a work for the renewal term, that grant did not vest with the grantee until the renewal term actually commenced (that is, the beginning of year 29). As a result of the U.S. Supreme Court's decision in *Stewart v. Abend*,[3] if such an author died before the end of year 28, all of the rights in the work immediately and entirely revert to the author's heirs, regardless of any agreements between the author and the grantee. The reverted rights include, among others, the right to create and exploit derivative works (such as a film script based on a book or play). The *Abend* case involved the rights to a short story that was the basis for the film *Rear Window.* Although the author granted rights to the renewal term, he died before its vesting. As a result, the rights to the story—including the right to exploit the script or the film based on the story—reverted to his heirs. Any further exploitations by the film studio were deemed to be copyright infringement. This concern over the vesting of renewal rights and their effect on derivative works is known among practitioners as an "*Abend* issue."

Abend is still very relevant today, especially for anyone lending against catalogs of motion pictures, television properties, theatrical productions or other derivative works. A factual and legal analysis needs to be undertaken to ensure that the rights to pre-1978 underlying works (scripts, books, articles, *etc.*) have not reverted to the original authors and, if they have, what effect this reversion will have on existing derivative works. If such a reversion has occurred, the owner of the derivative work (for example, a film studio) will need to obtain a new grant of rights from the heirs of the author of the underlying work (for example, the story on which the film is based) in order to continue to exploit the derivative work, including the right to make remakes and sequels. It should be noted that *Abend* issues only apply to pre-1978 underlying works because the 1976 Act created a single term of copyright and abandoned the renewal concept for post-1978 works.[4] Also important is that the publisher of a work that reverts under the *Abend* scenario retains the right to collect income with respect to prereversion exploitations of the work.[5] For example, if a 1977 musical composition reverts to the composer's heirs in 2004, the publisher of the composition may continue to collect royalties from exploitations of the composition, such as public performances, synchronizations and mechanical reproductions, that occurred up until the time of the reversion. Any exploitations occurring after the reversion, even exploitations of existing prereversion arrangements, or for which the date of exploitation cannot be determined, are within the control of the composer's heirs.[6]

Year 35

As part of its overhaul of U.S. copyright law, the 1976 Act created a new series of statutory termination rights for authors and other grantors. These rights

were created to help authors and other grantors by giving them a chance to reclaim rights that they might have given away cheaply at an earlier date due to a lack of bargaining power at the time. These rights do not apply to the creation of works made for hire, since the "author" of the work is deemed to be the party who commissioned it, or for conveyances by will.

The first opportunity for authors to exercise these rights is between 35 and 40 years after a grant of rights.[7] This termination right applies to any exclusive or nonexclusive grant of rights on or after January 1, 1978, and may only be exercised by the author(s) of the work, or the author's heirs (if the author is deceased). For example, if an author granted publication rights to a publisher in 1985, the author would have the right to terminate this grant during the period from 2020 through 2025. Subsequent grantees (for example, a publisher to whom the author granted rights) may not exercise this right, other than executors or administrators of the author's estate. The termination right is exercised by giving notice to the grantee between two and 10 years in advance of the effective date of the termination (that is, between two and 10 years ahead of the date between years 35 and 40 in which the rights will revert). For example, if the author described above wanted to terminate the grant of rights in 2020, the author would be required to provide notice to the publisher between 2010 and 2018.

The effect of the termination is that any and all rights under copyright revert to the author(s) of the work. This termination is as simple as it sounds: Any grantee (for example, a publisher, record company, *etc.*) that exploits a copyrighted work and that is the recipient of a termination notice must cease exploiting the work on the termination date. One notable exception to this broad reversion addresses the *Abend* case: The statute provides that derivative works prepared under the original grant may continue to be exploited, but this does not include the right to create new derivative works based on the original work. For example, the result in *Abend* could not occur following a termination under the 1976 Act, because the right to continue to exploit derivative works is preserved. The owner of a work based on an underlying work for which rights have been terminated, however, could not create a new sequel, remake or other new work based on the underlying work.

A key issue to consider is that this termination right survives *notwithstanding any agreement to the contrary*. In other words, even if an author signed a contract granting rights for the full duration of copyright protection, including renewals, the author may still exercise these termination rights. Moreover, even if an author signs an agreement not to exercise these termination rights, such author may exercise them nonetheless. It remains untested whether a new agreement with an author that purports to grant additional rights (assuming there are rights that remain to be granted) would be considered a completely new grant, which would effectively delay the exercise of termination rights for an additional 35 years.

Year 56

The 1976 Act provided for another termination right between 56 and 61 years after the date copyright was originally secured.[8] This termination right operates similarly to the year-35 termination right discussed above but with a few key differences.

The year-56 termination right is limited to pre-1978 grants of rights, unlike the year-35 right, which applies to grants made on or after January 1, 1978. However, unlike the year-35 termination right, the timing of the exercise of the year-56 termination right is based on the year in which the copyright was *secured*, not the year in which the rights were granted to a third party.

The year-56 termination right is exercisable by a greater range of rights holders. Unlike the year-35 termination right, the year-56 termination may be exercised by any grantee, in addition to an author (or author's heirs). However, the exceptions for works made for hire and conveyances by will remain applicable. As with the year-35 termination, the year-56 right is exercised by giving notice to the grantee between two and 10 years in advance of the effective date of the termination. For example, if the publisher of a 1960 song wanted to terminate an administration agreement for such song, the publisher would have the right to do so between 2016 and 2021. In order to effect such termination in 2016, the publisher would be required to provide written notice to the administrator between 2006 and 2014.

The effect of the termination is identical: a complete reversion of all rights granted under copyright to the grantor or author (depending on who exercised the right). The exceptions for existing derivative works also apply in this scenario. As with the year-35 termination right, the year-56 right may be executed regardless of any agreement to the contrary. However, if the termination is between a grantor and the original grantee (or its successor in interest), following delivery of the notice of termination (but before the termination has become effective), the grantor and such grantee may enter into a new grant of rights that will survive termination. The "original grantee" distinction could be important in a lending context because it could allow a borrower/publisher to negotiate for a new grant of rights from an author (thus avoiding a breach of a covenant), but it might not be available to a lender following foreclosure on the copyright collateral.

Year 75

The 1976 Act granted a final termination right between 75 and 80 years after the copyright was originally secured.[9] This right operates nearly identically to the year-56 termination right, but its application was limited to a narrower class of works.

As with the year-56 termination, the year-75 termination is exercisable by the author (or the author's heirs) or subsequent grantees and has the same effects as the year-56 termination.

In addition, the year-75 termination is limited to pre-1978 grants of pre-1978 works, and the timing of the termination right is based on when copyright was originally secured. However, the year-75 termination is limited to works that were in their renewal term (that is, after their first 28 years of copyright) on October 27, 1998, and for which the year-56 termination window has expired. For example, the heirs of an author of a 1938 play who granted print publication rights in 1955 would be able to exercise termination rights between 2013 and 2018 because the play was already in its renewal term on October 27, 1998, and because the termination rights for years 56 to 61 had already expired. In order to effect such termination in 2013, the heirs would need to provide notice to the publisher between years 2003 and 2016.

Protections for Lenders

Clearly, anyone structuring a loan that is secured in whole or in part by copyrights needs to be sure that the structure accounts for the terminations discussed above. The loss of a major copyright by a borrower could have devastating effects on the borrower and could result in the borrower's inability to repay the loan, the violation of loan covenants and potential exposure to the lenders. It behooves anyone involved in these processes to become familiar with these termination schemes and to retain advisers who have the knowledge and experience to assess the termination risks associated with particular copyrights. The prudent lender must assume that well-established authors and their advisers are fully aware of the rights described above and when and how they may be exercised and that they will likely exercise these rights (or use them as leverage in negotiations) when the opportunity arises. This should be taken into account in assessing the long-term value of any copyrights.

Endnotes

1 A commissioned work that meets the criteria discussed above may be considered a work made for hire if it is used "as a contribution to a collective work, as part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas" (17 USC §101).

2 *Id.*

3 *Stewart v. Abend,* 495 US 207, 110 SCt 1750 (1990).

4 The elimination of the need for a renewal filing for post-1964 works discussed above does not affect an *Abend* analysis. The elimination of the renewal filing was intended to help authors to avoid situations in which works fell into the public domain because of the failure to timely file the renewal application, which was generally seen as a formality. The issue of a work

falling (or not falling) into the public domain is separate from determining ownership of the rights in the work during the renewal term.

[5] *Mills v. Snyder*, 469 US 153 (1985).

[6] *Woods v. Bourne Co.*, CA-2, 60 F3d 978 (1995).

[7] 17 USC §203. The statute provides for variation of this timing depending on whether the work was published.

[8] 17 USC §304(c).

[9] 17 USC §304(d).

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