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October 9, 2020

VIA EMAIL

Regan Smith
General Counsel and Associate Register of Copyrights
U.S. Copyright Office
101 Independence Ave. SE
Washington, D.C. 20559-6000
regans@copyright.gov

Re: *Ex Parte* Letter re: October 6, 2020 Copyright Office Virtual Meeting

Dear Ms. Smith,

This letter is to follow up on the *ex parte* meeting held with Spotify on October 6, 2020. Attending the meeting on behalf of Spotify were Kevan Choset, Lucy Bridgwood, and Emery Simon, and Spotify's outside counsel Sy Damle and Allison Stillman of Latham & Watkins, and Andrew Pincus of Mayer Brown. Attending for the Copyright Office (the "Office") were Regan Smith, Anna Chauvet, John Riley, Jason Sloan, Terry Hart, and Cassie Sciortino.

During the meeting we addressed questions raised by the Office with respect to the Transition Period Cumulative Reporting and Transfer of Royalties to the Mechanical Licensing Committee. We also addressed points raised in the MLC's summary of its October 1, 2020 *ex parte* meeting. The following summarizes our discussion.

Spotify provided some additional context for its Pending and Unmatched Usage Agreement with the NMPA ("Agreement"), including the scale of the unmatched royalties at issue.

In that connection, Spotify pointed to the recent letter from Senate Judiciary Committee Chairman Graham, who emphasized that the entire purpose of the MMA was to "provide legal certainty for past, present, and future usage," to avoid burdensome litigation, and to protect copyright owners and songwriters, while ensuring that services are not burdened by double payments. To allow the dispute regarding the cumulative reporting and transfer of unclaimed royalties to remain unresolved would be particularly unfair because it would impose a burden on the very service providers that acted responsibly prior to enactment of the MMA, by finding ways to get royalties to publishers and songwriters notwithstanding the well-recognized flaws in the pre-MMA system. Those are the service providers whom the MLC would leave with the choice between double payments and the threat of litigation in the absence of a regulation.

Pending and Unmatched Usage Agreement: Releases, Holdback, and Market Share

In discussing the specific structure and operation of the Agreement, Spotify addressed several questions raised by the Office. With respect to the question of whether the Agreement extinguished the rights of copyright owners who received unmatched royalties pursuant to the Agreement to receive a further distribution of unmatched royalties under 17 U.S.C. § 115(d)(3)(J), Spotify confirmed that the Agreement extinguished such rights for the periods of time covered by the Agreement – not only because the copyright owner had already received unmatched royalties for those periods, but because the copyright owner had *released* any and all claims to such royalties. Put a different way, the unmatched royalties that may ultimately be available for distribution by the MLC on a market share basis pursuant to section 115(d)(3)(J) correlate to a "market" that does not include such owners: they do not have a "share of unclaimed accrued royalties" to claim, because they have already received that share and released that claim. Indeed, even if services chose to forego the MMA's limitation of liability, they would have zero liability to these copyright owners for those time periods because of those releases. Addressing a related question posed by the Office, this is also true with respect to royalties that are matched to such copyright owners for usage periods covered by the Agreement – such royalties are not payable again. A different result would effectively require the accrual of royalties that are not legally owed to anyone—a result that is both illogical and inconsistent with the standard accounting principles incorporated into the plain terms of the statute. 17 U.S.C. § 115(d)(10)(B)(1)(iv)(I).

Spotify addressed questions concerning the regulation proposed by the Digital Licensee Coordinator (DLC), pursuant to which digital services that paid out unmatched royalties under NMPA agreements would still transfer to the MLC the amount of royalties that were subject, per the terms of the agreement, to a "holdback." Spotify confirmed that this "holdback" reflects the portion of the market that NMPA and Spotify estimated as a conservative amount designed to cover the market share of non-participating publishers—and that Spotify's data reflected that the non-covered streaming during the relevant usage periods is likely even smaller than that. Spotify emphasized, however, that even in the unlikely event that this estimation and corresponding holdback amount turns out not to cover the royalty claims that were not released, the services would promptly pay whatever shortage there might be.[1] Spotify confirmed that it would do this even if the statute of limitations for infringement claims (as adjusted under section 115(d)(10)(C)) had passed before the MLC matched royalties to any such copyright owner.

In response to questions raised by songwriters regarding the structure and nature of the royalty payments made under the Agreement, Spotify pointed to the terms of the Agreement providing for calculation of the participating publishers' market shares based (in significant part) on matched usage outside of the claiming process. The effect of this was that publishers did not need to claim unmatched works—and, for the most part, did not do so[2]—in order to participate in

[1] This is not required by the statute, but is being offered to ensure that non-covered copyright owners can recover royalties that they might have claimed had they participated.

[2] Which is not surprising, given that tremendous difficulty in identifying works embodied in particular tracks is the key issue that both the NMPA agreement and the MMA were designed to address.

the market share distribution of unclaimed royalties at the conclusion of each claiming period.[3] Whether the payments made to copyright owners under the Agreement should, in turn, have been shared with their songwriter partners is an issue governed by the agreements between those parties. The legal and accounting result of the releases given to Spotify is the same: it extinguished Spotify's liability for – and thus its obligation to accrue – such royalties.

Textual Statutory Analysis

The Office asked about the interplay of section 115(d)(10)(B)(iv) (setting forth the obligation to accrue unclaimed royalties) and section 115(d)(10)(B)(iv)(I) (subjecting the accrual obligation to generally accepted accounting principles). Specifically, the Office asked whether the accounting standards only apply to "maintaining" accrued royalties once they are "accrued" by a digital music provider for each unmatched work, such that the initial accrual is somehow outside the scope of the GAAP rules. That construction is wholly inconsistent with the statutory text and, in addition, simply makes no sense. The two relevant provisions appear, in context, as follows:

> (iv) If the copyright owner is not identified or located by the end of the calendar month in which the digital music provider first makes use of the work, the digital music provider **shall accrue and hold royalties calculated under the applicable statutory rate in accordance with usage of the work, from initial use of the work until the accrued royalties can be paid to the copyright owner or are required to be transferred to the mechanical licensing collective, as follows**:
>
> (I) **Accrued royalties shall be maintained by the digital music provider in accordance with generally accepted accounting principles.**

To begin with, the phrase "shall accrue and hold royalties" is not unconditional. It says that a digital music provider must accrue and hold royalties *until* the royalties are "paid to the copyright owner" or "are required to be transferred to the mechanical licensing collective." Just as importantly—as required by the underlined phrase above, "as follows"—the subsequent Subclauses (I)-(III) describe how and when the royalties are accrued, paid to copyright owners, or transferred to the MLC.

Subclause (I) provides a general instruction that the royalties "shall be maintained" in accordance with GAAP—which means that GAAP standards apply to the initial calculation of the accrual as well as to any adjustment of that initial calculation in light of new facts. That is made clear by the fact that Clause (iv) ends with the phrase "as follows," which links the initial accrual determination described in Clause (iv) to the application of GAAP standards specified in Subclause (I). Indeed, the "shall be maintained" phrase is used frequently in connection with accounting principles to include all of a business's accounting determinations—because businesses "maintain" their books of account—and is not restricted to a subset of accounting determinations

[3] As a result, the portion of the royalties distributed on a market share, as opposed to matched, basis *does not* indicate that this portion of the unmatched royalties would have been matched to non-participating publishers.

made later in time, after some initial event (as the MLC appears to claim). *See, e.g.*, 24 C.F.R § 242.58(f) (books and records "shall be maintained in accordance with generally accepted accounting principles"); 47 C.F.R. § 54.702(e) ("books of account shall be maintained in accordance with generally accepted accounting principles"); 42 U.S.C. § 1109 (stating that an account "shall be maintained" as a separate book account).

The DLC explained in its August 17, 2020 comments (at p. 17) that publishers participating in the Agreement released all entitlement to royalties for usage during the period covered by the Agreement and, therefore, under GAAP, royalties owed to those publishers would no longer be "maintained" and only those royalties expected to be due to third parties who had not released such royalty claims would be accrued. That is the holdback amount under the Agreement, and the amount that would be accrued and ultimately transferred to the MLC.[4]

Indeed, this is how Subclause (I) *has* to work, in order to account for voluntary licenses more generally. For instance, if Spotify accrues and holds the royalties for an unmatched work, which it later matches to a publisher with whom it has a voluntary license, it would follow the terms of that license (*e.g.*, by paying royalties to that publisher under the terms of that license, or without paying any additional royalties at all in the case of a flat-fee license), and would de-accrue the appropriate amount. But Subclause (II), which generally addresses what a digital music provider is supposed to do with accrued royalties when it matches works to copyright owners, does not address voluntary licenses at all. Instead, it requires—regardless of the terms of any contrary agreement—payment of "all accrued royalties" on a specific timetable, accompanied by a statutorily mandated "cumulative statement of account." *See* 17 U.S.C. § 115(d)(10)(B)(iv)(II)(aa). It is *subclause (I)*—the GAAP provision—that allows DMPs to pay royalties under the terms of the voluntary license and then de-accrue royalties in that situation. And that is precisely what is happening here, with respect to claims for shares of unclaimed accrued royalties.[5]

This is why the MLC's suggestion that it should receive double payment of these already-distributed royalties, to hold them so that digital services and copyright owners can dispute claims to them, misses the mark. The royalties that have been paid out already do not exist to be turned over again. Any dispute over entitlement to such royalties as between the service and a copyright owner would be a dispute created in the first instance by the MLC's proposal; we are aware of *no* copyright owner who has released their claims to the royalties covered by the Agreement that is now demanding, or at any time since the Agreement has demanded, a double payment of those

[4] Even if this timing distinction were plausible, it would not result in a different outcome: if the "maintain according to GAAP" obligation didn't apply until after an initial accrual, once that GAAP obligation applied, the service would have to take account of the GAAP requirement to de-accrue for liabilities that were released--which would produce the same result described in the text.

[5] With respect to the MLC's suggestion that the Office need not regulate because digital music providers believe the statute is clear, the Office's intervention is necessary because the MLC has publicly and steadfastly stated that it will refuse to apply the plain text of the statute.

royalties. And any copyright owner who has *not* released claims to such royalties *will be paid* under the DLC's proposal.

Additional Context/ Termination of the Agreement

Spotify also provided additional context around its termination of the Agreement. Spotify determined not to renew the Agreement at the end of the term, the timing of which coincided with the passage of the MMA, because the MMA created a nearly-identical system of accruing and paying out unmatched royalties going forward – and, rather than potentially leaving an estimated 5-10% of the market of non-participating publishers out, the MMA solution necessarily covered everyone. Contrary to the mischaracterization apparently offered by the NMPA, in no way did the determination not to renew the Agreement reflect an understanding that for periods *already released*, *prior to the enactment of the statute* Spotify would be expected to re-accrue and transfer unmatched royalties again. Indeed, Spotify was extremely surprised to hear this mischaracterization, given that in its only discussions with the NMPA around its decision not to extend the Agreement, representatives of the NMPA reassured Spotify that there would never be an expectation of such double payment of unmatched royalties (including even for periods of time after passage of the MMA, if Spotify had chosen to extend the Agreement).

The MLC asserts that because the NMPA agreements are private agreements, one can expect that the contracting parties will honor the obligations in the agreements, or "be met with swift judgment" in court – such that any action by the Office is unwarranted. No one is questioning whether the parties to these agreements should abide by their terms. Rather, the outcome of these agreements — distributions of royalties and releases under a system created by the NMPA and used as a model for the MMA — must be taken into account in the cumulative statement of account required under 115(d)(10)(B)(iv)(aa) and subsequent distributions by the MLC. Implementing regulations addressing this issue are squarely within the Office's authority and statutory mandate.

* * *

In addition to the discussion summarized above, Spotify provided certain confidential details that are being summarized in a separate, confidential letter being provided to the Office contemporaneously with this letter.

We thank the Office for its time and thoughtful attention to this important issue, and remain available to provide any additional information the Office would find useful.

Sincerely,

s/*Allison Stillman*

Allison Stillman

CC via email: Jason Sloan
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