Before the
COPYRIGHT OFFICE
LIBRARY OF CONGRESS
Washington, D.C. 20024

In the Matter of	)	
	)	
Verification of Statements of Account	)	Docket No. 2012-5
Submitted by Cable Operators and	)	
Satellite Carriers	)	

COMMENTS OF THE PROGRAM SUPPLIERS

The Motion Picture Association of America, Inc. its member companies, and other producers and distributors of movies, series, and specials broadcast by television stations ("Program Suppliers") submit comments in response to the Notice of Proposed Rulemaking, 79 Fed. Reg. ("FR") 55696 (Sept. 17, 2014) ("Third Proposed Rule") in the above-captioned proceeding implementing the "verification" provisions of the Satellite Television Extension and Localism Act of 2010 (STELA). These comments address a single issue raised by the Third Proposed Rule.

DISCUSSION

Negotiated Settlements Provide A Fair and Valuable Means For Resolving Audit Differences Without Resort To Infringement Litigation

In situations where an audit shows that a licensee underpaid royalties, the Third Proposed Rule appears to preclude negotiated settlements as a means of resolving issues raised by the audit: "a licensee may cure the underpayments identified in the auditor's final report *only* by depositing the additional royalties due under the statutory license with the Office. Paying additional royalties directly to the participating copyright owners pursuant to a negotiated settlement would *not* satisfy this requirement." 79 FR at 55704/2 (emphasis added). Negotiated

settlements offer a fair and valuable means for audit parties to resolve differences and to discourage "free rider" problems.

The statute establishes a verification process under which "copyright owners should be given a single opportunity to audit a particular SOA, and that the auditor should review that statement on behalf of all copyright owners, regardless of whether they participate in the audit or not." 79 FR at 55704/1. This principle, which rests on the language of § 111(d)(6)(A)(i) along with that of § 111(d)(6)(D), limits the number of audits to which a licensee could be subject in a year by preventing different owners from instituting separate audits of the same licensee. The proposed regulations establish a public notice period that gives all copyright owners a single opportunity to opt in or opt out of the audit of designated SOAs, with the understanding that opt-out owners will not have another chance that year to audit other SOAs of that same licensee. In addition, opt-out owners, who pay no audit costs, have no control over or interaction with the auditor. Presumably, an owner would weigh these factors when deciding to opt in or to opt out.

A separate, more general Section 111 principle assures that "any copyright owner should be allowed to claim an appropriate share of additional royalty fees that result from the audit, even if that copyright owner did not join the audit or pay for the auditor's services." 79 FR at 55704/2, citing 77 FR at 35649 ("Copyright owner(s) who do not participate in the verification procedure would not be required to pay for the auditor's services, and consequently they would not be entitled to receive a copy of the auditor's report, although they would benefit from the payment of any additional royalty fees made as a result of the audit."). This principle is not limited to additional audit royalties, but applies more broadly in that § 111(d)(4) entitles eligible owners to share in all royalties contained in any year's fund, no matter how collected (*e.g.*, additional royalties collected due to the Licensing Division's SOA examination).

The interworking of these two statutory provisions creates a favorable climate within which an audit "free rider" problem can flourish. On the one hand, the regulations under § 111(d)(6)(A)(i) along with § 111(d)(6)(D), designed to limit the number of audits to which a licensee is subject, allow an owner to opt out of any proposed audit during the public notice period. While opting out prevents an owner from instituting a separate audit of the same SOAs, it also assures that the opt-out owner will not bear any audit costs. On the other hand, § 111(d)(4) entitles opt-out owners to share in whatever additional royalties result from the audit. The confluence of the two statutory provisions creates the classic conditions for a free rider problem to flourish because opt-out-owners will *always* receive the same benefit (their pro rata share of additional audit royalties) while paying *none* of the audit cost. That is unfair to opt-in-owners who are forced to pay *all* the owner-assigned audit costs, but receive only *some* of the resulting audit benefits.

Allowing negotiated settlements between the opt-in owners and the audited licensee would substantially reduce the free rider problem risk. Currently, the Third Proposed Rule seems to discourage negotiated settlements by stating that the "only" way to cure an auditor-uncovered underpayment is "by depositing the additional royalties due under the statutory license with the Office." 79 FR at 55704/2. The Rule suggests that to do otherwise "would unfairly prevent non-participating owners from claiming an appropriate share of those payments." *Id.* But factoring the free rider problem into the analysis shows allowing negotiated settlements is not unfair.

Non-participating (opt-out) owners are not "unfairly" treated by negotiated settlements where monies go directly to opt-in owners participating in the audit. The possibility of this result would be another factor that owners presumably would consider when deciding whether to opt-in or opt-out of an audit. With negotiated settlements as a possibility, an owner is not *guaranteed* to

obtain a share of additional audit royalty payments whether or not the owner opts in or opts out, as is the case where deposit with the Copyright Office is the only option. During the public notice period, an owner can undertake a cost-benefit analysis: does the certainty of paying no audit costs outweigh the risk of not benefitting from royalties paid to opt-in owners via negotiated settlement?[1] Undertaking this type of cost-benefit analysis could also improve the process by decreasing the likelihood of audits in marginal situations where a majority of copyright owners determine the audit costs outweigh potential benefits.

As the cost-benefit evaluation incorporating possible negotiated settlements can be performed during the public notice period, it is not unfair that an owner who freely decides to opt out receives none of the benefits from a possible negotiated settlement because that owner also pays none of the audit cost. In addition, negotiated settlements, like direct deposit with the Copyright Office, provide a valuable mechanism for avoiding infringement litigation related to royalty underpayment, thus furthering the objective of the audit rights process.

Respectfully submitted,

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October 16, 2014

[1] Negotiated settlements are a "risk," not a certainty, because the parties may decide against a negotiated settlement, and, instead, deposit any underpayments with the Copyright Office.