Before the
UNITED STATES COPYRIGHT OFFICE
Washington, D.C.

In the Matter of: Mechanical and Digital Phonorecord Delivery Compulsory License	Docket No. 2012-7

JOINT REPLY COMMENTS

The Digital Media Association, National Music Publishers' Association, Inc. ("NMPA"), Recording Industry Association of America, Inc. ("RIAA"), The Harry Fox Agency, Inc. and Music Reports, Inc. ("Music Reports") (collectively, the "Joint Commenters") submit these Joint Reply Comments in response to the Copyright Office's Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.

The Joint Commenters' principal purpose in submitting these Joint Reply Comments is to address certification requirements for statements of account under Section 115 in light of further discussions among the Joint Commenters and the initial comments filed by Christian L. Castle and Gear Publishing Company ("Gear") in this proceeding. The Joint Commenters also respond briefly to the comments by Mr. Castle and Gear concerning certain other issues raised by the NPRM.

I. Certification of Statements

As indicated in the Joint Commenters' initial Joint Comments, the current certification language for both monthly and annual statements is problematic. Because the certification requirements present very technical issues of public accounting practice, figuring out solutions to the problems of the current certifications proved to be the most difficult challenge the Joint Commenters encountered in their discussions of compulsory license accounting requirements.

The time for filing reply comments in this proceeding arrived before NMPA and Music Reports were able to reach agreement on specific language for certification of statements. However, all the Joint Commenters agree generally on the underlying principles that should govern such certifications. Resolving this matter is an important issue in this proceeding. The Joint Commenters respectfully suggest that the Office consider further process, such as convening a meeting to discuss issues concerning certification, to facilitate a considered resolution of the issue.

In this part of these Joint Reply Comments, the Joint Commenters first review some of the problems with the existing certification language. We then describe the extent of our current agreement regarding how to solve these problems. We then conclude this part of these Joint Reply Comments by describing how that which we agree on responds to certain points concerning certification that were raised in the comments filed by Mr. Castle and Gear.

A. The Existing Certification Language

The Joint Commenters agree with Mr. Castle that it is important that the statement of account regulations provide a reliable method for certification of accountings. Unfortunately, the current certification provisions at 37 C.F.R. § 201.19(e)(6) and (f)(6) are inconsistent with modern use of the compulsory license and, in the case of the annual statement certification, modern public accounting practice. Thus, the current certification regulations have failed to achieve the larger goal of providing copyright owners reasonable comfort that they are being accounted to properly.

In the case of both monthly and annual statements, the certifications assume human review that is impracticable except in the case where a licensee prepares only a handful of statements by a partly manual process. Some licensees do in fact make only limited use of the compulsory license and prepare their accounting statements that way. The Joint Commenters

agree that the statement of account regulations should continue to provide certifications geared to such small-scale use of the compulsory license.

However, that approach is insufficient for large-scale use of the compulsory license. A large scale user cannot meaningfully review thousands of statements by having a person cast his or her eye over them. Large-scale users of the compulsory license use computerized processes to generate their statements, and manually checking individual computer-generated statements would be a pointless exercise. The way to assure that such statements are reliable is to gain comfort with the input usage data and the processes used to generate the statements, rather than to examine the individual statements.

Beyond this critical practical issue, the current annual statement certification also presents technical problems relating to public accounting practice. Section 115 requires the Register to adopt regulations providing for certification of annual statements by a CPA. 17 U.S.C. § 115(c)(5). Public accountancy is a regulated profession, subject to ethics rules adopted by state regulators and, as a practical matter, professional standards adopted by the American Institute of CPAs ("AICPA"). Thus, the Joint Commenters understand the statutory requirement that the Office adopt regulations providing for certification of annual statements by a CPA implicitly to require the Office to adopt regulations that are consistent with the professional obligations of CPAs. The current annual statement certification is out of step with current professional standards for CPAs and the current opinion practices of many auditors. Specifically:

- The current certification states that the examination is to be made under generally accepted auditing standards. The current version of such standards is AU § 150, Generally Accepted Auditing Standards, *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-

00150.pdf. Related publications interpreting such standards are available at http://www.aicpa.org/Research/Standards/AuditAttest/Pages/SAS.aspx. However, these are standards for audits of financial statements. While certifications often may be given by CPAs who also audited the licensee's financial statements, certification of statements of account is a distinct activity, and the standards referenced in the current certification seem inapplicable to that activity.

- As a result, the current certification asks a CPA to render a professional opinion different than the one that applicable professional standards indicate a CPA should render when completing an audit under generally accepted auditing standards. *See* AU § 110.01, Responsibilities and Functions of the Independent Auditor, *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00110.pdf.
- The certification required by the current regulations is more akin to the certification that applicable professional standards contemplate when a CPA completes an examination under the AICPA Attestation Standards. However, it is not fully consistent with the requirements for a CPA's examination report under those standards.

Because Section 115 requires the Register to adopt regulations providing for certification of annual statements by a CPA, 17 U.S.C. § 115(c)(5), the Joint Commenters believe that the Office should adopt regulations in this proceeding that are consistent with applicable professional standards for CPAs.

B. The Extent of the Joint Commenters' Agreement on Certification

NMPA and Music Reports are expected to file separate proposals with respect to the specific regulatory language concerning certification of monthly and annual statements of

account, and RIAA is expected to address certification of statements for small-scale use of the compulsory license in its comments. Certification language should provide reasonable assurance to copyright owners that they are receiving accurate statements, while also recognizing the reality of large-scale use of the compulsory license, not imposing undue costs on licensees, conforming to applicable professional standards for CPAs, and permitting licensees to obtain from major audit firms examination reports that will pass muster with their opinion committees.

In the case of monthly statements, the Joint Commenters agree that the regulations should provide two alternative forms of certification – one targeted for small-scale use of the compulsory license and one targeted for large-scale use of the compulsory license. The first of those, which was set forth in Section 210.16(f)(1) of the proposed regulations attached to the Joint Commenters' initial Joint Comments (the "Proposed Regulations"), is in substance the same as the existing monthly statement certification. The second should reflect the reality that for large-scale use of the compulsory license, a compulsory licensee can only certify a monthly statement based on comfort with the data and processes used to generate statements. Thus, a licensee choosing to use this certification would certify as to such matters.

In the case of annual statements, the Joint Commenters also agree there should be alternative forms of certification. The first again should be targeted to small-scale use of the compulsory license. As in the case of the current annual statement certification, it would contemplate examination of specific statements, leading to a professional opinion of a CPA that is equivalent to the current certification. However, the technical problems with the current certification (described above) should be corrected.

The second alternative should be targeted toward large-scale use of the compulsory license. A licensee using this option would need to secure a professional opinion of one or more CPAs directed to the data and processes relevant to generation of its annual statements. Where

the licensee chooses to generate its own annual statements, one CPA might suffice to perform both examinations. Where the licensee uses a service provider to generate its annual statements, a CPA engaged by the service provider would be permitted to examine the processes used by the service provider to generate the annual statements. The Joint Commenters agree that the requirement of an examination of the processes used by a service provider to generate the annual statements could be satisfied by a standard AICPA report and opinion concerning the service provider's internal controls (referred to as a SOC 1, Type 2 report).

The Joint Commenters also agree that the regulations should not specify exact certification language for annual statements. Instead, they should describe the substance that must be included in the CPA certification. If the required substance of the certification is anchored in appropriate professional standards, it is not necessary to provide exact certification language to have a rigorous certification process. Describing the substance rather than prescribing exact language would avoid incorporating excessive and unnecessary detail into the regulations, and would permit flexibility at the detail level to permit CPAs to exercise their professional judgment with respect to the particular circumstances involved and to accommodate future changes in applicable standards.

C. Certification Issues Raised by Mr. Castle and Gear

The comments filed by both Mr. Castle and Gear address the subject of certification. At the most general level, we understand both sets of comments to advance the proposition that certification, and particularly annual statement certification by a CPA, should be a rigorous process that gives copyright owners meaningful assurance that the statements they receive are likely accurate. The Joint Commenters agree with that proposition.

The Joint Commenters' agreement concerning the matters described above is responsive to various specific points raised by Mr. Castle and Gear. Thus, for example:

- We agree that the regulations should identify applicable professional standards, as Mr. Castle suggests on pages 10-11 of his comments.
- We agree that to render an appropriate opinion for a retailer, the CPA would need to be satisfied that all of the retailer's relevant transactions were reflected, as Mr. Castle suggests on page 12 of his comments.
- We agree that the regulations should take into account employment of third-party licensing agents, as Gear cautions on page 16 of its comments. The licensee should be required to provide a certification taking into account the work of such agents. No licensee should be able to "hold up their hands and say 'it wasn't me' or 'oops'" due to the actions of such an agent. Gear Comments, at 16.

In other respects, it would be unnecessary or inappropriate for the regulations adopted in this proceeding to address the comments of Mr. Castle and Gear concerning certification. Thus, for example:

- Mr. Castle's comments generally extol the virtues of royalty examinations conducted by copyright owners. However, that is not the process contemplated by Section 115(c)(5). His concerns about reliability would be fully satisfied by a certification process along the lines we have described above.
- Mr. Castle suggests on pages 10-11 of his comments that the Office should elaborate on applicable AICPA standards. That is not necessary, because AICPA standards are quite exhaustive and were adopted by expert technical bodies of the AICPA. Any effort to improve on their work risks creating a situation in which the mechanical accounting regulations are inconsistent with the professional obligations of CPAs, which would frustrate the statutory command that annual statements be certified by CPAs.

- Mr. Castle suggests on page 11 of his comments that the Office should require public disclosure of any limitations on the books and records examined. That is unnecessary. Inevitably a CPA will need to make professional judgments about what evidence he or she examines in accordance with the professional standards of the AICPA, but the CPA ultimately must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in his or her report.
- Mr. Castle makes various suggestions on pages 12-13 of his comments generally directed to the problem of unpayable royalties. The Office should not act on these suggestions. The Office has no authority to address, in its rules for accounting under the compulsory license, use of works that are not licensed under the compulsory license. Within the realm of compulsory accounting, the statute and regulations contemplate various situations in which royalties may not be payable. *E.g.*, 17 U.S.C. § 115(c)(1) (copyright owner not identified in the Office's records); 37 C.F.R. § 201.19(e)(7)(i) (absence of payment information from agent); 37 C.F.R. § 201.19(e)(7)(ii) (undeliverable payment). Mr. Castle's comments seem to suggest that every copyright owner receiving an annual statement under a compulsory license should be assured that there are not other copyright owners who are going unpaid by virtue of those provisions. That makes no sense. Mr. Castle's comments also would create an unacceptable fraud risk by inviting the public to make claims to unpayable royalties.
- Mr. Castle suggests clarifying the application of state unclaimed property statutes, and even that the Office investigate compliance with such statutes. The substance and enforcement of such statutes is obviously a matter for the relevant states, and well beyond the authority of the Office and the scope of this proceeding.

- At page 16 of its comments, Gear suggests that the Office require certification of royalty reports provided by third party services to licensees. That proposal exceeds Section 115(c)(5), which provides for certification of annual statements, not third party royalty reports.
- Gear also suggests special disclosure in the case where an agent processing payments for a licensee also handles licensing matters for the copyright owner. It is unnecessary and would be inappropriate for the Office to seek to regulate in these accounting regulations the relationship between musical work copyright owners and their agents.

II. Other Issues Raised by the Castle and Gear Comments

Apart from certification, the initial comments filed by Mr. Castle and Gear fundamentally take exception to aspects of the Section 115 compulsory license system that are statutory or otherwise beyond the jurisdiction of the Office. Thus, this proceeding simply cannot address many of the matters raised in their comments, including rates, the possibility of opting out of the compulsory license, and remedies for a licensee's non-compliance. To the extent that Mr. Castle's and Gear's comments reflect business and policy perspectives concerning matters that are germane to this proceeding, the Office should recognize that they are out of step with broad industry consensus concerning these matters.[1] However, in the remainder of these Joint Reply Comments, the Joint Commenters respond to their principal arguments concerning other issues raised in the NPRM.

[1] Mr. Castle does not even identify who he is representing in this proceeding, so the Office cannot evaluate whose perspective he is actually offering.

A. Performance Royalties that Have Not Been Finally Determined

At page 3 of its comments, Gear seems to propose that when performance royalties have not been finally determined, an interim rate that is 135% of the old performance rate should be used. That plainly would not work if there is no old performance rate to be used. There also is no basis to believe that 135% is an appropriate estimate of the change in performance royalties from rate period to rate period.

Alternatively, Gear suggests that estimated performance royalties should be determined by the performing rights organizations. This is in effect what the Proposed Regulations do when they suggest that in estimating the performance royalty, a service may use the aggregate amount of public performance royalties then sought by performing rights licensors, provided such an approach is supportable under GAAP. *See* Proposed Regulations, § 210.16(d)(3)(i).

B. Rounding

The thrust of Gear's comments concerning rounding is that rates should be higher. That is, of course, a matter for the Copyright Royalty Judges. *See* 17 U.S.C. § 801(b)(1). Accepting the current rates, as the Office must, the proposal in Section 210.16(d)(3)(ii) of the Proposed Regulations is appropriate.

C. Electronic Payment

Gear's points concerning electronic payment (page 7 of Gear's comments) seem largely consistent with the Proposed Regulations. Electronic payment is inherently consensual. It is thus not evident that the accounting regulations need to address the matter at all, although the Joint Commenters believe that it may be helpful to include in the regulations a brief statement that such arrangements are permissible. *See* Proposed Regulations, §§ 210.16(g)(9), 210.17(g)(7).

D. Electronic Statements of Account

Gear's comments at pages 7-8 illustrate that copyright owners have varying preferences concerning the form of delivery of statements. Gear's preference to receive paper statements is accommodated in the Proposed Regulations.

The Office should decline Gear's invitation to specify details of electronic delivery. No such details will fully satisfy everyone. Instead, the marketplace supports multiple means of electronic statement delivery. The options and preferences will inevitably change over time. The Joint Commenters' proposal adequately addresses Gear's concerns, because if a copyright owner does not like the electronic delivery method used by a licensee, it may discuss the matter with the licensee (who may agree to make an accommodation), and in any event the copyright owner could obtain paper statements as Gear says it prefers. *See* Proposed Regulations, §§ 210.16(g)(3), 210.17(g)(3).

E. Minimum Payment Threshold

Gear's comments at pages 9-10 oppose a minimum payment threshold. However, other aspects of its comments illustrate the issues that compel the Joint Commenters to propose such a threshold. At page 6 of its comments, Gear complains about receiving one dollar of income, and at page 8, Gear complains about the costs for copyright owners to process royalty statements for small amounts. For services making available a full catalog of recordings, mechanical royalty payments in the range of a dollar or less are common, and the costs they engender are a real issue for licensees and copyright owners alike.

Where essentially every recording is available online but there is little demand for many recordings and songs, it is inevitable that some copyright owners will receive low payments. Fewer than 10% of recordings typically represent more than 90% of usage of a digital music service, and many of the remaining recordings have very little usage. No rate will ensure that

copyright owners receive a high level of income from songs that hardly anyone happened to purchase or listen to through a service.

Gear suggests that the answer is advances. Gear's proposal is contrary to the statutory requirement that royalties be paid for phonorecords that are distributed, 17 U.S.C. § 115(c)(2), and simply unrealistic. Services would sooner take down unpopular songs than pay a $100 advance per unpopular song. For songs generating only a small amount of income, the real alternatives are (1) seeking to moderate the overhead associated with legitimate use of the songs, so as to facilitate such use, or (2) imposing a compliance burden that may risk that such songs will not be made available through legitimate channels. We believe the former is the better choice, and so proposed a minimum payment threshold in Section 210.16(g)(6) of the Proposed Regulations. However, if a copyright owner wished to demand payments on a current basis, our proposal would provide that option.[2]

F. Promotional Royalty Rate

Gear's comments at pages 11-14 oppose the concept of a "promotional royalty rate." This is not the proper forum to address rate issues, but 37 C.F.R. § 385.14 is an existing rate provision, and its extension is unanimously supported by all participants in the pending rate proceeding, including publisher and writer groups. The participants support this structure because it is an efficient and protective way of enabling certain activities that are widely

[2] Gear provides an example of a licensee distributing 549 downloads of each of 500 recordings without paying any mechanical royalties. However, that is inconsistent with our proposal. The proposed payment threshold applies at the copyright owner level. A licensee's use of multiple songs from the same copyright owner would be aggregated to determine whether the threshold is exceeded. In addition, under our proposal, an accrual of less than $50 could be deferred until the time for annual statements, but not indefinitely.

accepted and important to legitimate music markets.[3] The Office's task in this proceeding is to enable accounting under the rate structure adopted by the Copyright Royalty Judges, and that includes 37 C.F.R. § 385.14. In doing so, the Office should understand that Gear is an outlier in its opposition to that provision.

It is also clear that Gear does not understand the promotional royalty rate structure as it exists in 37 C.F.R. § 385.14 and as proposed for the coming rate period. Instead, Gear's comments are directed at uses well beyond the scope of the promotional royalty rate as it exists and is proposed to be extended. The real promotional royalty rate – in contrast to the straw man criticized by Gear – is not a rate for "[p]ractically any use of music [that] can be construed by the licensee as a 'promotional tool.'" Gear Comments, at 11. This rate structure covers only limited uses, which are well less than the range of uses suggested by Gear on page 12 of its comments and the rights discussed by Gear on page 13 of its comments. The rate structure applies only to reproduction and distribution rights implicated by preview clip streaming, time-limited streaming on certain sites, and limited free trial periods for the various types of services covered by the percentage rates.[4] Eligibility for the promotional royalty rate is tightly circumscribed by two and one half printed pages of generally-applicable conditions in 37 C.F.R. § 385.14(a), and additional conditions applicable to specific uses. Gear says at page 12 of its comments that effective

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[3] The Joint Commenters also note that there is no legal impediment to the Copyright Royalty Judges' adopting a zero rate in accordance with applicable provisions of Chapter 8 of the Copyright Act. The 2.75¢ rate specified in Section 115(c)(2) is subject to adjustment by the CRJs in accordance with Chapter 8. Nothing in Chapter 8 suggests that a zero rate is impermissible if properly determined in accordance with the applicable standards. Other provisions of the Copyright Act plainly indicate that Congress does not perceive any inconsistency between statutory licensing and a zero rate. *See* 17 U.S.C. § 122(c).

[4] The treatment of free trials is tightly coupled to the percentage rate structure adopted in the last two rate settlements. Within the context of those settlements, including free trial uses among uses receiving an allocation of a particular mechanical royalty pool would complicate administration, but not result in higher aggregate payments to musical work copyright owners.

promotions most often involve artist participation. In fact, streaming from official artist websites is an important category that is covered by the promotional royalty rate. *See* 37 C.F.R. § 385.14(c). Gear likewise asserts on page 13 of its comments that promotions should be temporary events, and the promotional royalty rate incorporates temporal limits for all uses but preview clip streaming (which is necessary at all times to enable sales from download stores). *See, e.g.*, 37 C.F.R. § 385.14(b)(2) & (3), (c)(1).

For the uses really covered by the promotional royalty rate, Gear is wrong that accounting for these uses should be "the most stringent." Gear Comments, at 12. These uses are ubiquitous and supported by a broad consensus of the affected industries. It is likewise widely accepted that these uses are not generally reported to anyone, and that it would make no sense to process zero rate uses through royalty accounting systems. The recordkeeping provisions contained within the promotional royalty rate structure are the better way to address these uses.

G. Timing of Annual Statements

At pages 16-17 of its comments, Gear opposes extension of the deadline for delivery of annual statements. Gear is of course right that computers are used in compiling sales data, but that misses the point of annual statements. Under the compulsory license, sales data is reported to copyright owners on a current basis in the form of monthly statements. Annual statements serve primarily to convey the CPA certification. Reconciling a year's reporting and obtaining CPA certification of that reconciliation is a complicated process that is not fully automated and thus requires time. First, a licensee needs to complete the last monthly accounting of the year. Then, for percentage rate uses, the licensee should complete its annual financial statement audit. It is really only at that point that a licensee appropriately should focus on the specific process of statement certification. One quarter really is not enough time for all of that. Forty-five days certainly is not. Six months after the fiscal year end is a deadline appropriate to the task.

H. Statements for Past Periods

The Joint Commenters agree with Gear's observation on page 17 of its comments that the Office's proposal concerning statements for past periods is unclear.

Mr. Castle addresses this issue on pages 9-10 of his comments under the rubric of a "safe harbor." The Joint Commenters agree with Mr. Castle that a limited safe harbor that is clearly expressed would be appropriate.

That is why the Joint Commenters proposed that when an annual statement for a fiscal year after March 1, 2009 was not provided because it was impracticable for the licensee to provide it, and the copyright owner still wants it, there should be a mechanism for the statement to be provided in conformity with the regulations adopted in this proceeding. That mechanism is provided in Section 210.17(h) of the Proposed Regulations.[5]

However, we disagree with Mr. Castle concerning certain aspects of this issue that he urges the Office to address. It is unnecessary for the Office to address the statute of limitations for infringement, because that is provided by Section 507 of the Copyright Act and cannot be varied in this proceeding. It is likewise unnecessary for the Office to interpret state unclaimed property statutes, because they are creatures of state law, and the Office cannot make them more broadly applicable than they are by their own terms.

I. Record Retention

On pages 17-18 of its comments, Gear proposes that licensees be required to keep usage records for at least 15 years after making the relevant royalty payments. That is such a long time

[5] Gear also proposes that the Office exclude certain types of uses from the scope of the compulsory license. The scope of the compulsory license is provided by Section 115, and the Office plainly has no authority to narrow it.

as to make the subject matter of the records ancient history, and so far beyond the statute of limitations period that it cannot possibly be justified.

J. Harmless Errors

Gear's comments on pages 18-19 concerning harmless errors are not clearly inconsistent with the Joint Commenters' proposal. Rules as complex as these accounting regulations provide a lot of room for noncompliance that has no practical effect at all. To prevent such errors from becoming the subject of technical infringement claims such as those Gear mentions, the Office should adopt the provision in Section 210.19 of the Proposed Regulations.

K. Confidentiality

In its comments on page 19, Gear overreacts to a provision that others in the affected industries view as unobjectionable. The provision included in the proposed settlement of the rate proceeding does not prevent publisher personnel from seeing a licensee's statements of account if there is a legitimate reason for them to do so. In a small company like Gear, the provision may well permit access to statements of account by every employee of the company. The provision included in the proposed settlement of the rate proceeding also does not prevent music publishers from providing their ordinary accounting to writers.

While Gear insists that there should be no limitations on what a copyright owner does with reporting information, Gear does not suggest any legitimate reason why a publisher should need to use or disclose competitively-sensitive information about services for reasons other than administering payments by those services. Preventing that is the focus of the clause, and was considered by the parties to the settlement to be important to operation of the percentage rate structure. Gear's mere preference to be unrestrained is not a sufficient reason to compromise this sensitive information.

CONCLUSION

In view of the foregoing, the Joint Commenters respectfully request that the Office adopt the Proposed Regulations with additional certification language consistent with the discussion in Part I above. Because of the importance and technical complexity of the certification issue, the Joint Commenters respectfully suggest that the Office consider further process, such as convening a meeting to discuss issues concerning certification, to facilitate a considered resolution of the issue.

Dated: December 10, 2012

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