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Via email

Regan Smith
General Counsel and Associate Register of Copyrights
Anna Chauvet
Associate General Counsel
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United States Copyright Office
Library of Congress
101 Independence Ave. SE
Washington, DC 20559-6000

Re: Docket No. 2020-12
Summary of The MLC's participation in ex parte call regarding Transition Period
Cumulative Reporting and Transfer of Royalties to the Mechanical Licensing
Collective (the "Proceeding")

Dear Ms. Smith, Ms. Chauvet and Mr. Sloan,

This letter summarizes the participation of the Mechanical Licensing Collective (the "MLC") in the November 13, 2020 ex parte call ("November 13 Call") between the Copyright Office (the "Office") and numerous participants concerning the above-referenced proceeding. The MLC thanks the Office for its time and attention in meeting with the parties concerning the Proceeding.

The persons participating in the November 13 Call for the MLC were Kris Ahrend (CEO), Ellen Truley (CMO), Alisa Coleman (Chair of the Board of Directors), Bart Herbison (Board member), Phil Cialdella (Chair of the Unclaimed Royalties Oversight Committee), Kay Hanley (Vice Chair of the Unclaimed Royalties Oversight Committee), and counsel Benjamin Semel and Mona Simonian.

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On behalf of the Office, Regan Smith, Anna Chauvet, Jason Sloan, John Riley, and Cassandra Sciortino participated in the call.

The following summarizes the MLC's substantive participation in the call:

In response to a question from the Office, the MLC confirmed that its goal is to match all unmatched uses, including all historical unmatched uses for which accrued royalties are transferred to the MLC, and to minimize the incidence of unclaimed accrued royalties. The MLC's position has always been, and remains, that it can and will hold unmatched royalties for longer than the required minimum statutory period where appropriate in service of this goal.

The MLC agreed with comments made by a number of call participants concerning the conflict between the language in the Supplemental Notice of Proposed Rulemaking in this proceeding ("SNPRM") and the text of the MMA. As noted by the Recording Academy and the National Music Publishers' Association ("NMPA"), the MMA sets forth a clear directive that all unmatched royalties be transferred to the MLC as a precondition for the limitation on liability. Particularly since the copyright owners of unmatched works are by definition not known or located, there cannot be private agreements that dispose of these unmatched royalties prior to the required transfer to the MLC. The MLC discussed the statutory language in detail in its *ex parte* letters of October 5 and October 16, 2020. The MLC agrees with the Recording Academy's pointed observation that the MMA could have provided for exclusion of moneys paid in private settlement agreements, but plainly did not. All of the agreements that the DLC has identified as relevant were executed prior to the passage of the MMA. There is no basis for concluding that the MMA intended to do the opposite of what it explicitly states, particularly where the issue was ripe for discussion prior to the MMA's passage, and the DMPs were the interest group drafting and motivating this limitation on liability language.

The MLC further emphasized its concern that the changes in the SNPRM revolve around a problematic interpretation of generally accepted accounting principles ("GAAP"), which itself occurs only after ignoring specific statutory direction (*lex specialis*) in favor of general language. All of the proposed changes surrounding the settlement payments require as a precondition that general language on maintaining accrued royalties in accordance with GAAP can be read to negate the other, more specific statutory language of the MMA that requires *all* unmatched royalties to be accrued and held, and *all* accrued royalties to be transferred to the MLC.

The MLC is concerned that the SNPRM may be read to promote an incorrect reading of GAAP and the MMA. As discussed on the call, the MMA itself provides for accrued royalties

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to be maintained in accordance with GAAP. Insofar as the DLC believes that this language authorizes its position,¹ there is no need for additional regulatory language. The SNPRM goes further, though, appearing to promote a particular interpretation under GAAP, that “[a]ccrued royalties can cease being accrued royalties within the meaning of 17 U.S.C. 115(e)(2) if the digital music provider’s payment obligation is extinguished, such as pursuant to a voluntary license or other agreement whereby the digital music provider is legally released from the liability by the relevant creditor copyright owner.” SNPRM § 210.10(b)(1).

As was noted on the call by multiple participants, the “relevant creditor copyright owner” is not known in connection with unmatched royalties. Rather, the MMA explicitly lays out the one way that accrued royalties can cease being accrued royalties by virtue of extinguishing the payment obligation, namely after being *matched*. Section 115(d)(10)(B)(iv)(II) lays out that where unmatched works are matched, the associated royalties must be paid to the now known copyright owner, thereby extinguishing the payment obligation and the accrual for those royalties. But where the copyright owner is not known, there can be no agreement with the “relevant” copyright owner to extinguish rights, and the SNPRM’s language appears to bless a reading of GAAP and the MMA that conflicts with both.

The MLC also discussed the SNPRM citation to the FASB Accounting Standards Codification in connection with its discussion of the added GAAP language. 85 Fed. Reg. 70546, fn 25 (citing FASB ASC 405-20-40-1). The MLC first noted that the cited paragraph does not support the interpretation in the SNPRM. The full text of FASB ASC 405-20-40-1 is:

Unless addressed by other guidance (for example, paragraphs 405-20-40-3 through 40-4 or paragraphs 606-10-55-46 through 55-49), a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

- a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
 1. Delivery of cash
 2. Delivery of other financial assets
 3. Delivery of goods or services
 4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.

¹ The DLC has stated that it believes the plain MMA text authorizes its position. *See, e.g.*, DLC

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- b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

As this paragraph makes clear, if “and only if” there is payment to the creditor or a release “judicially or by the creditor” is derecognition appropriate. It cannot be disputed that neither of those things will exist with respect to unmatched royalties, where the creditor is not even known. The MLC also noted the first clause of the cited paragraph, which indicates that it is subject to other guidance, and specifically FASB ASC 606-10-55-49, which states:

An entity should recognize a liability (and not revenue) for any consideration received that is attributable to a customer’s unexercised rights for which the entity is required to remit to another party, for example, a government entity in accordance with applicable unclaimed property laws.

This paragraph underscores the conclusion reached from 405-20-40-1 itself, that derecognizing liabilities for unmatched works is not appropriate under GAAP.² Here, the MMA creates a specific obligation to remit unmatched royalties to another party, namely the MLC. Even the specific example is analogous to this situation. The MLC’s role with respect to unmatched royalties is analogous to that of a government entity in connection with unclaimed property laws, and the MMA preempts state law concerning escheatment in favor of the MLC’s handling of unmatched royalties. Section 115(d)(11)(E).

Both NMPA and Songwriters of North America (“SONA”) inquired on the call as to the basis for the accounting analysis behind the SNPRM language concerning GAAP interpretations, with SONA noting that it seems to be outside the scope of typical Office rulemaking. The Office declined to comment, although noted that the language on derecognition of accrued royalties is being considered and could be removed. The MLC emphasized that all of the SNPRM’s proposed changes concerning settlement payments rest on

Comments to NPRM at 12 (discussing “clear text of the statute”).

² A DMP that disagrees and also believes that the MMA’s language “maintained in accordance with GAAP” provides for such derecognition is free to rely on the MMA’s language. It is the additional language in the SNPRM that appears to bless a particular GAAP and MMA interpretation that is problematic.

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the problematic reading of GAAP and the MMA. The MMA itself does not provide for, and is not consistent with, the complicated system of estimating and truing up unmatched royalties that is proposed by the SNPRM.

The DLC stated on the call that some DMPs who had entered into settlements “don’t have the money” to pay all unmatched royalties. This echoes statements by the DLC in its comments to the NPRM, such as:

Indeed, some DMPs simply do not have the financial resources to make duplicate payments. ...

[I]t is likely that some DMPs that paid out all of their accrued royalties pursuant to an NMPA distribution agreement would not be able to now double-pay these accrued royalties to the MLC; they simply don’t have the money. (DLC Comments to NPRM at 11, 15)

The DLC’s repeated statements that some DMPs are unable to pay the full unmatched liability highlights the prejudice that the Office’s rule could work on the MLC and copyright owners. Regardless of any speculation that such DMPs may be inclined to offer concerning what portion of unmatched royalties might match to copyright owners with who they settled (or the enforceability of those settlements), the reality is that the copyright owners of unmatched works are simply not known until matched, and when matched may not line up at all with a DMP’s estimates of who they thought they would be. This is part of why it would be inappropriate for a DMP to derecognize these liabilities under GAAP (even if the MMA allowed it, which it does not). The inability to pay accrued liabilities generally signals insolvency, and these statements appear to signal that there are DMPs affected by the SNPRM language that may either be insolvent and/or did not accrue the full unmatched liability on their financial statements in the first place, as directed by the MMA. The SNPRM language, which would allow DMPs to transfer to the MLC less than the “all accrued royalties” that the MMA directs, and true up later, would have the practical effect of impeding the ability of copyright owners to bring claims for infringement where there is a failure to comply with Section 115(d)(10)(B). The sanction of estimates would cloak noncompliance and copyright owners would have infringement claims on hold pending clarity on whether the proper unmatched royalties were transferred, all while other creditors of a troubled DMP enforce their rights. By the time it becomes clear that the DMP is not eligible for the limitation on liability, the DMP

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could be out of business, leaving copyright owners with no remedy.³ Furthermore, it could leave the MLC in the position of matching a historical use but not having the funds to pay the associated royalties, because the DMP went out of business in the interim. These scenarios look far from unlikely, particularly given the DLC's statements that some of the DMPs involved in these settlements do not currently have assets sufficient to cover the unmatched royalty liability. These concerns highlight additional problems with departing from the clear language of the MMA into the murky waters of the SNPRM's complex system of GAAP interpretations, estimates, true ups, royalty payments that do not match royalty reporting, impeded ability to prosecute statutory noncompliance, and retroactive paths to limitation on liability.

The MLC agreed with the comments of other participants that the SNPRM would shift the MMA's heavily negotiated default position for accrued royalties to put the burden of litigating compliance with the MMA onto copyright owners, allowing DMPs to unilaterally withhold unmatched royalties in their discretion. Copyright owners would not merely be required to litigate whether the transfer was proper, but would have to do so knowing that, even if they were successful, the DMP would merely have to release the improperly withheld funds to reacquire a limitation on liability, depriving the copyright owners of the attorneys' fees and statutory damages that are essential to a just remedy. The complex litigation of these issues, which would likely implicate expert testimony surrounding DMP GAAP practices and related financial records, the reasonableness of transfer estimates, the contracts at issue themselves, and the validity of the Office's rule and retroactive provisioning to reobtain limitation on liability after a court found it had not been obtained (which seems the most likely procedural position in which the issue would be decided), appears likely to generate far more litigation activity than a DMP simply enforcing its claimed unambiguous contractual right to be repaid royalties that match to copyright owners with who it has private agreements.

The MLC stressed that it holds unmatched funds with interest pursuant to the MMA, and paying accrued royalties to the MLC does not lead to a forfeiture of the DMP's contractual rights. On the contrary, the MLC has stated that it holds funds subject to legitimate legal dispute in suspense, and pays such funds with interest to the appropriate party when the dispute is resolved by the parties or an appropriate tribunal.

³ The SNPRM provision tolling the limitations period for royalty payments where estimates are made would not help where the DMP went out of business in the interim, nor would it provide for the fees and statutory damages that the Copyright Act has long recognized are essential to making copyright infringement enforcement viable. SNPRM at § 210.10(c)(5)(vi).

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Finally, the Office asked the MLC for its interpretation of Section 115(d)(10)(B)(iv)(II), and particularly whether the statutory language requires an expansive reading of the GAAP provision in order for unmatched works that a DMP later matches to a voluntary license to be paid pursuant to the voluntary license terms. The MLC expressed its reading that Section 115(d)(10)(B)(iv)(II) is fully consistent on its face with the payment of royalties under voluntary license terms. The subsection provides that, when a DMP matches an unmatched work, it shall pay all respective accrued royalties to the identified copyright owner “in accordance with this section and applicable regulations.” Neither “all accrued royalties” nor “in accordance with [Section 115]” precludes the application of voluntary license terms. On the contrary, Section 115(c)(2)(A)(i) explicitly accommodates voluntary licenses, providing that, “[I]license agreements voluntarily negotiated at any time between one or more copyright owners of nondramatic musical works and one or more persons entitled to obtain a compulsory license under subsection (a) shall be given effect in lieu of any determination by the Copyright Royalty Judges.” “Accrued royalties” are “calculated in accordance with the applicable royalty rate under this section,” which as described above, accommodates voluntary license terms. Section 115(e)(2). The MLC further noted its understanding that GAAP would not have application to this question in any event. If the MMA had a specific instruction that a DMP must pay matches at statutory rates (which it does not), such an instruction could not be overridden and a new rate applied simply under authority of GAAP, which is a set of rules and standards for financial reporting.

The MLC appreciates the Copyright Office’s time, and is available to provide further information on request.

Sincerely yours,



Benjamin K. Semel