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Submitted Electronically

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Tanya M. Sandros
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U.S. Copyright Office
101 Independence Ave. S.E.
Washington, D.C. 20559-6000

Re: In the Matter of the Mechanical and Digital Phonorecord Delivery Compulsory License, Proposed Regulations for Reporting Monthly and Annual Statements of Account for the making and distribution of phonorecords, Docket No. 2012-7

Dear Deputy General Counsel Sandros:

These comments are respectfully submitted in response to the Copyright Office's Notice of Proposed Rulemaking dated July 27, 2012 and request for written comments on issues regarding proposed regulations for reporting Monthly and Annual Statements of Account for the making and distribution of phonorecords.[1]

The following comments are summarized after discussing the issues concerned with certain of our clients who are songwriters or that are musical composition copyright owners or administrators.

I will first offer some commentary on the state of the industry regarding compulsory licenses in the online environment, and then offer some suggestions for solving the problem of rendering certified statements of account based on discussions with concerned songwriter, music publisher and administrator clients. The purpose of my comments is first to emphasize that the absence of an audit right under Section 115 has caused a lack of confidence in royalty reporting, and then to suggest that the confidence in reporting can be improved significantly by the Copyright Office adopting robust certification regulations.

[1] 77 FR 44179 (July 27, 2012) and 77 FR 55783 (September 11, 2012).

1. **Interest of the Copyright Owners**

(a) Historical Uses of Section 115: As you are no doubt aware, the compulsory license for non-dramatic musical works available under 17 U.S.C. 115[2] was not widely used prior to the advent of the online music business in approximately 2001. Even today, most record companies either send the publisher an advice letter for artist or producer-written songs subject to a controlled compositions clause or request a mechanical license directly from publishers for "outside" songs.

We have struggled to find one record company that got into business relying solely or even mostly on the Section 115 license. On the other hand, it is common for digital retailers to assert a right to rely on the Section 115 compulsory license when launching their businesses. The practical reality is that these digital retailers offering a large number of sound recordings (typically over 10 million) are required to send large numbers of notices under Section 115.

These notices are frequently sent in paper format which makes processing licenses and tracking royalties very difficult even by major publishers. We have been informed that some retailers or their agents offer to streamline this process with electronic statements, but purport to impose click through license terms on the unwary publisher seeking relief from this "paper chase" by enticing the publisher to "log in" to an account system they cannot access without agreeing to additional terms.

It is difficult to quantify the statutory royalties that have never been paid, have never been disclosed, and that cannot be verified. And yet because of the compulsory nature of the Section 115 license, songwriters cannot opt out, and unless they know that their song has been improperly licensed, even have difficulty exercising the limited termination rights available to them under the Copyright Act.

While the Copyright Office is currently proposing regulations applicable to all compulsory licensees, most of the problems with the license that we have experienced in the marketplace relate solely to digital retailers. Of those problems, almost all can be solved by permitting the rights holders to conduct an industry standard royalty compliance examination of digital retailers—a right that is not permitted under the Section 115 regulations as currently drafted.[3]

[2] Herein, the "*Section 115 compulsory license*" or "*compulsory license*."
[3] Compare audit rights of sound recording owners for sound recording performance royalties under 17 USC Sec. 114 at 37 C.F.R. 380.6 "Verification of Royalty Payments".

Given the seemingly endless delays in resolving these issues, every year that passes makes it more likely that songwriters will not be paid royalties they are owed by digital retailers. In some cases, verification of these royalty payments goes back over 10 years. Companies have come and gone, been acquired or changed their offerings or management. We have been told that these companies both resist allowing an industry standard compliance examination and refuse to provide certified statements of account, yet continue to rely on the Section 115 license on the flimsy excuse that it is the Copyright Office who is at fault for failing to issue the regulations that are the subject of the instant inquiry.

And yet these same retailers are able to render statements—just not certified statements.

I find this Kafka-esque situation to be rather difficult to believe.

(b) Songwriters' Expectation of Integrity: The Congress determined that songwriters should be denied the ability to opt out of licensing their songs, and also decided that the government and not the marketplace should determine the price at which songwriters should be compensated for certain exploitations of their works under Section 115.

As one Nashville songwriter put it, "Why does a top session player get double scale, but a top songwriter doesn't get double statutory?"

A good question.

Section 115's remedies for non-payment or non-compliance by a compulsory licensee are limited to sending a termination notice—assuming there was even a proper statutory license in the first place that is capable of termination. If the termination notice is simply ignored, it is then up to the songwriter or music publisher to sue in order to enforce their rights. Very often this puts the songwriter up against very large, well funded, and in some instances litigious public companies who can easily outlast the songwriter in court.[4]

This stark reality contributes to the ennui of learned helplessness that is all too common when the creative community is confronted with public or venture backed digital retailers who fail to comply with the requirements of Section 115, yet want to continue to use the music.

[4] Although not the subject of this inquiry, the Register's excellent proposal of a "small claims" copyright remedy would be well suited to address these inequities.

If the Congress is to force songwriters into this difficult situation by removing their ability to opt out of the Section 115 compulsory license, I respectfully submit that the Copyright Office ought to consider the reasonable expectations of songwriters and music publishers that the system that Congress created have at least as much integrity as the integrity available in the marketplace through a royalty compliance examination of the digital retailers. The certification requirements of 37 C.F.R. 201.19 are the conceptual analog of the compliance exam, yet there seems to be a breakdown in rendering compliant statements.

In the words of one leading songwriter paraphrasing The Who's *We Won't Get Fooled Again*, "Meet the new boss, worse than the old boss."[5]

(c) Certifications are a Critical Step in a Reliable Compulsory License Regime: Without a reliable certification of accountings in a Section 115 compulsory license regime, songwriters are asked to essentially rely on the kindness of strangers. This was not an acceptable position for songwriters and the marketplace created a solution: royalty compliance examinations under direct licenses. I respectfully submit that the Copyright Office should seek to create in new regulations for Sec. 201.19 at least a comparable level of integrity as songwriters would enjoy with a robust royalty compliance examination. An effective certification regime would also benefit digital retailers because every day that passes creates an ever more frustrated class of songwriters who one might easily anticipate will eventually seek collective action in the courts.

Historically, direct licenses issued to record companies by songwriters or music publishers typically required a contractual right to conduct a royalty compliance examination of reproductions made by the releasing record company in no small part in exchange for waiving the then-current regulations that would otherwise apply.

For example, a "mechanical license" issued by the Harry Fox Agency ("***HFA***") frequently stated that the license issued by HFA on behalf of its publisher principal incorporated by reference the provisions of the Copyright Act under Section 115 except as modified by the HFA license. One of those modifications was almost invariably that HFA would be entitled to conduct a compliance examination under the mechanical license concerned. This "standard Harry Fox Agency license" became the industry standard, and is referenced just that way in many contracts.

A sensible reason for songwriters or music publishers to waive certain of the Section 115 compulsory license statutory provisions relating to reporting (quarterly instead of

[5] David Lowery, *Meet the New Boss, Worse Than the Old Boss* (April 15, 2012) available at http://thetrichordist.wordpress.com/2012/04/15/meet-the-new-boss-worse-than-the-old-boss-full-post/

monthly, for example) in exchange for the right to conduct a royalty compliance examination is that the current regulations[6] and especially 201.19 essentially create a moral hazard for the compulsory licensee that the current regulations seek to solve by bringing in a third party certified public accountant.[7] In the historical case, a record company relying on a Section 115 compulsory license would have been the only entity in the manufacturing and distribution chain that had the ability to verify whether it complied with the law and rendered accurate Statements of Account[8].

That would mean that the compulsory licensee would be determining what was paid to the copyright owner and the copyright owner would have little recourse to confirm the accuracy of the payment under the Section 115 compulsory license.

It should come as no surprise that Section 115 compulsory licenses were disfavored in the music industry, and songwriters instead opted for robust royalty compliance examinations conducted by the publisher whose rights were at issue, or by experts on behalf of the publishers such as HFA.

Some examinations were large undertakings, such as those conducted by HFA, and resulted in significant recoveries.[9] Examinations are an important part of preserving

[6] The current regulations set forth at 37 C.F.R. 201.18 and 201.19 are hereinafter referred to collectively as "current regulations" available at http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=a71104dd9f045002681202f3f302a5d4&rgn=div5&view=text&node=37:1.0.2.6.1&idno=37#37:1.0.2.6.1.0.197.18

[7] The requirement of having a CPA certify annual statements of account was presumably intended to bring an independent review, but the regulations do not require that the CPA be "independent", meaning that it is possible that the compulsory licensee could exert undue influence over the certification process.

[8] Monthly and Annual Statements of Account under 37 C.F.R. 201.19 are sometimes referred to herein as simply "*Statements of Account*."

[9] Alfred Pedecine, then Senior Vice President and Chief Financial Officer of HFA, testified in a 2008 matter before the Copyright Royalty Judges that HFA's royalty compliance examinations recovered $430 million in additional royalty payments from 1990 to 2007 (available at http://www.loc.gov/crb/proceedings/2006-3/copyright-owners/findings-public-final.pdf):

> ***(b) HFA Has Recovered Hundreds of Millions Through Audits***
>
> …HFA regularly conducts [Royalty Compliance Examinations or "RCEs"), or audits, of licensees in order to evaluate their compliance with the terms and conditions of mechanical licenses issued by HFA and to assess whether licensees are paying royalties in full…. Alfred Pedecine, Senior Vice President and Chief Financial Officer of HFA, testified that HFA's RCEs recovered $430 million in additional royalty payments from 1990 to 2007….This amount represents approximately 6.2% of HFA's total receipts from licensees for that period….NMPA President and CEO David Israelite testified: "It's millions upon millions of dollars that we collect through our process and [we are] probably not finding close to everything that we're owed. It's almost as if

integrity in the mechanical license system. Denying songwriters and publishers an audit right invites corruption--as NMPA President and CEO David Israelite said of the necessity of royalty examinations, "It's almost as if you had a tax system where there were no penalties if you didn't file your taxes."[10]

All publishers large and small typically have the right to audit record companies to this day under direct mechanical licenses, and no record company would realistically think that it could get away with denying a publisher the right to "audit."[11] In fact, some might even say that by allowing a publisher to cause the record company to open its books, the publisher felt less of a need to conduct an examination since it was able to do so.

Digital retailers should also be subject to these industry standard solutions for verification.

2. Trust But Verify: Digital Retailers Reliance on Section 115

Digital retailers have availed themselves of the Section 115 compulsory license for the so-called "streaming mechanical" for limited downloads and streams.[12]

> you had a tax system where there were no penalties if you didn't file your taxes." Every RCE that HFA has ever conducted has identified underpayments or failures to pay.
>
> 847. HFA's audits typically identify a number of deficiencies in licensees' royalty reporting and payment, including deficiencies in accounting, inventory and recordkeeping processes and procedures….In some circumstances, the deficiencies appear to be the result of carelessness, but in other situations, the licensees appear to have willfully neglected to live up to the requirements imposed by the mechanical licenses that they have obtained from HFA or their obligations under the Copyright Act. For example, record companies sometimes simply use the Copyright Owners' works without obtaining licenses through HFA or directly from the relevant publisher. In other instances, they obtain licenses, but underreport their use of the licensed compositions. In other situations, record companies distribute significant numbers of "promotional" copies of recordings for which they do not pay royalties, even though these units are not exempt from royalty payments under either the relevant mechanical license or the Copyright Act. Another common occurrence is the maintenance of excessive reserves in violation of the regulations found in 37 C.F.R. § 201.19. In addition, audits have uncovered some licensees with unaccounted-for production, which means that the licensee's records show that the units were manufactured and distributed, but no royalties were reported, paid or accrued.

[10] Id.
[11] But see the current YouTube independent publisher license which denies small publishers an audit right.
[12] We leave open the question of whether the benefits of Section 115 are even available or ought to be available to digital retailers as a threshold matter.

Music publishers often find out that the digital retailer is relying on Section 115 for these uses when they receive a notice of the retailer's intention to use the work under Section 115(b). While I do not have an exact count of how many of these notices (or "***NOIs***" have been sent to music publishers by digital retailers, we understand anecdotally that there are "tens of thousands," or "hundreds of thousands," or "millions" of these notices in the recollections of some of the recipients we spoke to.[13]

Whichever of these numbers is accurate, the phrase we hear most often to describe this process is "carpet bombing NOIs" which I think conveys the feeling of helplessness on the part of songwriters faced with this onslaught—a burdensome transaction cost frequently not covered by subsequent earnings.[14]

It should be apparent that the ability to "carpet bomb" notices under Section 115 creates a perverse incentive to send massive quantities of NOIs in hopes of insulating the digital retailer from at least willful infringement claims.

Combining the ability to "carpet bomb" NOIs with an ability to refuse a compliance examination in a legalistic reliance on the current regulations adds injury to insult for songwriters. In fact, it seems that even the casual observer could conclude that there was a possibility, if not a substantial likelihood, that "carpet bombing NOIs" without a compliance verification process in place could easily result in a significant misallocation of royalty payments required by the Copyright Act.

With the increasing shift from physical to digital sales and with digital retailers relying on the Section 115 license almost exclusively for significant music offerings, the Copyright Office is faced with a situation where what was once a backwater of compulsory licensing of relatively small importance to the survival of music publishers and songwriters is becoming a torrent of mistrust for what holds the promise of being a significant income stream.

3. Basic Accounting Statements Can Be Rendered Under the Current Regulations

In this section, I will distinguish "accountings", being noncompliant royalty accountings rendered on an ad hoc basis by digital retailers and "Statements of Account" that compulsory licensees (including digital retailers) are required to render by the current regulations.

[13] While "millions" of NOIs may sound extreme at first blush, it follows that if a digital retailer licenses millions of sound recordings to launch a service, there could also be millions of NOIs.
[14] See, e.g., Will Page and Eric Garland, *The Long Tail of P2P*, available at http://www.prsformusic.com/creators/news/research/Documents/The%20long%20tail%20of%20P2P%20v9.pdf

A common response from some digital retailers is that they are not able to render certified Statements of Account because the Copyright Office has failed to promulgate new regulations for streaming mechanicals.[15] Yet these same retailers are able to render accounting statements (of dubious veracity, but rendered nonetheless), and at least one agent for digital retailers was able to render what purported to be a certified Annual Statement of Account. So it appears that if there was a will, there was a way to comply with the statutory requirements.

After discussing the issue with clients, one frequently cited source of mistrust is the relatively common practice of half-hearted compliance with the current regulations[16] by digital retailers. After "carpet bombing" NOIs, the retailer renders a noncompliant accounting and frequently pays royalties—based on the retailers own accounting systems. The basis for these noncompliant accountings is unclear, but these documents appear to have been created based on the retailer's own interpretation of the existing regulations or interpretations by third party intermediary accounting services engaged by the retailer.

I am also aware of only one royalty accounting service that has rendered certified Statements of Account, and at that has rendered those certifications for 2011 only.[17] Based on our discussions with clients, a common complaint is that the Statements of Account when rendered include earnings for songs they do not own or do not include songs that are top earners that the songwriters expected to be included on statements but are not. This leads to a lack of confidence in any of the retailer's documents.

A lack of confidence also leads to the perception that the current regulations as drafted permit retailers or their services to render statements of indeterminate veracity and that those statements could have been certified but the noncompliant retailer chose not to certify. It also appears that there are at least theoretically some retailers who may *never* have rendered a certified statement—not ever. Some of these uncertified statements could apply to exploitations over the last ten years.

For the handful of services that have rendered a certified Statement of Account, the real and apparent mistakes in these statements has lead to the suspicion that whatever

[15] These regulations would apply to reporting under the rates established by the *Final Determination of Rates and Terms of the Copyright Royalty Board*, 2006–3 CRB DPRA (74 FR 4510, January 26, 2009, amended 74 FR 6832, February 11, 2009).

[16] Available at http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=a71104dd9f045002681202f3f302a5d4&rgn=div5&view=text&node=37:1.0.2.6.1&idno=37#37:1.0.2.6.1.0.197.18

[17] As a threshold matter, it is unclear whether the certification itself was in compliance as many if not all the services that were part of the certification do not appear to have complied for prior years and could be subject to termination.

certification was performed was insufficient. Such statements do not satisfy the policy behind the regulations—providing creators with confidence that they are being properly accounted to for the Section 115 compulsory license they cannot opt out of.

It also appears that there may well be a meaningful backlog of accrued but unpaid royalties—a "black box". Of course, the publishers and songwriters cannot determine whether this backlog of unallocated monies exists because the retailers refuse to permit a compliance examination and the certification process does not seem to be catching these issues.

In fact, there are some songwriters we have spoken to who believe that if one sat down to design a system with the purpose of creating a large pool of unallocated royalties (and therefore unpaid royalties), one would be hard pressed to think of any angles that are not covered in the current state of affairs.

In other words, there is a supportable perception that some digital retailers want all of the benefits of the statutory license, but few of the burdens—especially the burden of paying a "straight count." All of this could be solved by requiring digital retailers to submit to the industry standard royalty compliance examination or a right to "audit".

As the Copyright Office does not indicate that it is able to replace the regulations regarding Section 115 compulsory licenses with an audit right available to all copyright owners large and small, I would respectfully suggest that the Copyright Office should avoid being used as a foil for those who fail to comply with existing regulations on the flimsy excuse that the Copyright Office has not promulgated regulations applicable to accountings.

4. New Safe Harbor

I will turn now to respectfully submitting some suggestions to the Copyright Office on important but relatively minor repairs to the current regulations.

It appears from the draft regulations that the Copyright Office is considering offering statutory licensees an *additional* six month period *after* the proposed regulations become effective[18] in which to render compliant statements. This additional "safe harbor" would mean that starting today there would likely be a minimum period of nine months or longer before publishers could expect to receive the certified statements they are entitled to and which could easily have been previously rendered under the current regulations.

[18] See proposed Section 210.27 "Timing of Statements of Account" 77 FR 44197 (July 27, 2012).

It appears that implementing this "safe harbor" plan will be challenging, and I would respectfully request that the Copyright Office consider the following issues:

(a) Granting an additional safe harbor rewards the noncompliant retailers and punishes the compliant ones;

(b) Offer a clear explanation of the effect of the safe harbor on the statute of limitations for infringement;

(c) Set forth a date certain on which certified Annual Statements of Account must be rendered and for which years;

(d) Provide a clear explanation of the record keeping requirements for compulsory licensees taking advantage of the safe harbor if they have failed to provide certified Statements of Account going back further than the documentation requirements of the proposed new section 210.18;

(e) Provide clear guidance to retailers regarding the reporting of any unallocated or unlicensed compositions; and

(f) Clearly state the applicability to digital retailers of state unclaimed property statutes on accrued but unpaid or unclaimed royalties.

5. Certification Requirements

While the new "safe harbor" is of concern, by far the most important aspect of the new regulations seems to be the certification process because it is that process that has the hope of instilling confidence in the system, not to mention getting songwriters paid.

Based on the only certified annual statement of account that I have found, it appears that the certified public accounting firm certifying the statement relied on attestation standards that may or may not be applicable to the certifications under the statutory license. It would be very helpful in any new regulations for the Copyright Office to identify the specific attestation standards that will be acceptable. Respectfully, it may be simple for a lawyer to write in a reference to third party standards, but the better course would be to review those standards and offer specific guidance on applying the standards rather than letting the moral hazard of royalty payments color that application.[19]

[19] The CPA certifying the statements is, after all, engaged and paid by the party to whose advantage it is that the statement not be questioned.

In addition, I respectfully suggest that the Copyright Office should specify in new regulations that the certified public accountant certifying Annual Statements of Account must perform their certification review in accordance with the attestation standards designated by the Copyright Office. These standards should be designed to enable the digital retailer or any third party it engages to prepare Annual Statements of Account so that these standards achieve the related control objectives.

Because the attestation standards go to the heart of the transparency that should be the objective of the current and new regulations, any contracts or understandings between the certifying accountant and the compulsory licensee regarding the books and records that are the subject of the examination should be written and should be publicly disclosed.

What we have found is that there is a general—and I believe erroneous--impression that having Annual Statements of Account certified by a CPA means that the actual systems of the licensee have been verified for accuracy, underlying sales reports verified, and that the CPA essentially conducts a royalty compliance examination with the rigor of HFA or an experienced royalty auditor.

Based on what little we have been able to determine about the contracts and understandings under which these certifications have been conducted, it is equally possible that the CPA and the licensee agreed upon what books and records would be "certified" and that the certifying CPA may have done little to verify the accuracy of the books and records upon which the statements were based. It appears that the CPA is simply verifying that 1 plus 1 does in fact equal 2, or close to it.

6. Suggested Revisions to Certification Standards

I would respectfully remind the Copyright Office that the proposed regulations are essentially creating a substitute for transparency of the industry standard royalty compliance examination. Therefore, the certifying CPA should expect to disclose and certify information that will help copyright owners both large and small understand what has happened inside of what is all too frequently perceived to be a black box.

I respectfully suggest that the following be considered for mandatory questions to be answered publicly by the certifying CPA:

(a) Has the licensee represented to the CPA that it has complied with all statutory requirements for obtaining a valid Section 115 compulsory license for all songs covered by the CPA's certification? This is significant because the CPA cannot certify what the licensee has not licensed;

(b) Has the CPA confirmed that all of the retailer's transactions were included on the Statements of Account and have been or are to be reported to all copyright holders on the Annual Statements of Account that the CPA is certifying?

(c) Are there any earnings held or accrued by the digital retailer for reasons other than an unknown song publisher for the period covered by the certification?

(d) Are there any earnings held for songs owned by unknown copyright owners?

(e) Has the digital retail or its third party representatives complied with the rules applicable to any unknown copyright owners for the period covered by the certification including filing a Notice of Intention to Obtain a Compulsory License with the Licensing Division of the Copyright Office?

We respectfully suggest that the Copyright Office consider these concepts when revising the certification requirements for annual statements of account.

7. **Transparent Disclosure of Missing or Unlicensed Works**

Another major concern that we have heard from songwriters is that there be some feedback loop in the process so that they can determine whether their works are unlicensed, monies are available for them, or the retailer is unable to find them following a reasonably diligent search.

Each digital retailer should be required to post on its website a public statement of all musical works in the following categories.

(a) Unlicensed Report: Works that the retailer has made available to the public but which were not the subject of a notification of intent to use, or which otherwise remains unlicensed. This would include a list of musical works for which the digital retailer has no contact information for the copyright owner;

(b) Unallocated/Unclaimed Royalty Report: Works for which the retailer has sent an NOI, but for which the retailer has failed to pay royalties for whatever reason. The Unallocated/Unclaimed Report should include amounts for which the retailer has accrued but not paid royalties and which will be transferred to the applicable unclaimed property authorities in the state in which the retailer has its principal place of business;

(c) Unknown Copyright Owner Report: Works for which the retailer has been unable to identify the copyright owner. This report should offer a searchable list and also identify works for which the retailer has filed the appropriate NOI with the Copyright

Office. It may make sense for all retailers to pool these lists into one searchable database so that songwriters would only have to search one database rather than multiple sites they might be unaware of or might contain misspellings. Such a database would be an ideal activity for an industry-wide group such as the Digital Media Association and would go a long way to restoring songwriter confidence in DiMA members; and

(d) Unclaimed Property Statutes: Finally, it would be helpful for songwriters to have a clear understanding of how unpaid or unclaimed royalties would ultimately be paid by the digital retailers to States under applicable unclaimed property statutes. Thanks to the hard work of a leading artist lawyer, the New York Attorney General conducted an investigation of unpaid record and music publishing royalties in 2004 and determined that over $50 million was available to be paid to creators.[20] It seems only fair that a similar investigation be conducted into digital retailers and the Copyright Office is in a perfect position to come to the aide of songwriters.

Thank you for the opportunity to offer these suggestions to the Copyright Office.

Sincerely,

Christian L. Castle

CLC/ko

cc: Distribution

[20] See *Musicians to receive $50 million in royalties*, Chicago Tribune, May 5, 2004, available at http://articles.chicagotribune.com/2004-05-05/business/0405050239_1_royalties-gen-eliot-spitzer-emi-group-plc