

Before the  
**COPYRIGHT ROYALTY BOARD**  
**LIBRARY OF CONGRESS**  
Washington, D.C.

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In the Matter of )  
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DIGITAL PERFORMANCE RIGHT IN )  
SOUND RECORDINGS AND EPHEMERAL )  
RECORDINGS )  
)  
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Docket No. 2005-1 CRB DTRA

TESTIMONY OF

**BARRIE L. KESSLER**

**Chief Operating Officer, SoundExchange, Inc.**

**October 2005**

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## **QUALIFICATIONS**

I am the Chief Operating Officer of SoundExchange, Inc. ("SoundExchange"). I have held this position since July 2001. Before I became Chief Operating Officer, I served as SoundExchange's Senior Director of Data Administration, beginning in November 1999. Prior to that, I worked as a database and technology consultant for the Recording Industry Association of America, Inc. (RIAA) for seven years. There, I developed the certification system for Gold, Platinum and Multi-platinum record sales, and created the royalty distribution system for the Alliance of Artists and Recording Companies (AARC).

My responsibilities as SoundExchange's Chief Operating Officer include overseeing the collection and distribution of royalty payments for the performance of sound recordings on webcast, cable, and satellite services. In this capacity, I supervise SoundExchange staff who receive royalty payments from webcasting and broadcasting services, determine the amounts owed copyright owners and performers, and distribute the royalties to those individuals and entities. Additionally, I oversee SoundExchange's license compliance activities, manage its budget, and coordinate its systems requirements, development, and testing. A statement of experience is attached to my testimony.

## **OVERVIEW**

In Section I of my testimony, I describe how SoundExchange collects and distributes royalty payments. In Section II, I discuss a number of issues related to the terms that are adopted for the administration of the statutory licenses found in 17 U.S.C. §§ 112(e) and 114(d)(2). Among other things, I briefly explain the importance of full and accurate census data to SoundExchange's ability to distribute royalties to their rightful owners, a topic that has been thoroughly reviewed in SoundExchange's filings with the Copyright Office and the Copyright Royalty Board ("CRB" or "Board") in the notice and recordkeeping rulemakings. I also explain

why a collection/distribution system with a single agent responsible for both collecting and distributing royalties is more efficient and reliable than a system with multiple agents. Finally, I address proposed changes to a number of the terms currently applicable to eligible nonsubscription transmission services and new subscription services.

## DISCUSSION

### **I. SOUNDEXCHANGE'S COLLECTION AND DISTRIBUTION OF ROYALTIES**

#### **A. Overview of SoundExchange**

SoundExchange is a 501(c)(6) nonprofit performance rights organization established to ensure the prompt, fair and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for the use of sound recordings over Internet, cable, and satellite radio services (hereinafter collectively "services" or "licensees") via digital audio transmissions. Originally an unincorporated division of the RIAA, SoundExchange was separately incorporated in September 2003.

Collecting royalties from hundreds of services and distributing the royalties to thousands of payees is an enormous undertaking. To fulfill its function, SoundExchange has invested significant time and money to develop systems that facilitate the receipt and distribution of royalties in the most efficient manner possible. Working together with statutory licensees, artists, unions and record labels, we endeavor every year to streamline our processes and ensure that the maximum amount of royalties we collect are paid out to those entitled to them. SoundExchange has automated many of its functions (and such automation is critical to ensuring efficient distribution of royalties), but, in many cases, SoundExchange staff still must undertake the laborious process of tracking down individuals entitled to royalties and correcting or completing misreported performance data.

Although SoundExchange is a non-member corporation, we frequently refer to those record labels and artists who have specifically authorized us to collect royalties on their behalf as “members.” We have thousands of such record label and artist members, but also pay non-members — copyright owners and performers alike — as if they were also members. We do not discriminate between members and non-members; in fact, current Copyright Office regulations require us to treat members and non-members equally when initially allocating statutory royalties. Members, however, can agree among themselves as to alternative distribution policies as described in more detail below, *see infra* at 13.

SoundExchange has been the representative of artists and record labels on a vast array of issues, including notice and recordkeeping and rate-setting through the CARP process and the new CRB process. Throughout, on behalf of all artists and record labels, SoundExchange has sought the establishment of marketplace royalties and regulations that enable the prompt, fair and efficient distribution of royalties to all those artists and copyright owners entitled to such royalties.

#### B. Royalty Collection and Distribution

SoundExchange’s core mission is to collect and distribute statutory royalties as efficiently and accurately as possible. As discussed throughout this statement, SoundExchange has made significant investments in systems and infrastructure and personnel to perform the task of royalty collection and distribution. These investments were made over several years and will likely require further improvements (“extensions” in the language of software developers) as the demands on the royalty system increase over time. For example, we will strive to further reduce costs by automating certain functions and will look to increase the frequency of our distributions.

For managing royalty collection and distribution, SoundExchange employs the following operational procedures. I have attached a flow-chart illustrating these steps as SX Ex. 211 DP.

Step 1: Payment and Log Receipt

SoundExchange's Royalty Administration Department receives from statutory licensees royalty payments and, ideally, three reports: Statements of Account ("SOAs") that reflect the licensee's calculation of the payments for the reporting period; Notices of Election which indicate whether the licensee has utilized any optional rates and terms pursuant to 37 C.F.R. § 262.3(a); and reports of use that log performances of sound recordings. Samples of these reports are provided as SX Ex. 212 DP, SX Ex. 213 DP, and SX Ex. 214 DP.

Upon receipt of payment from a licensee, the payment is logged into our licensee database. If this is the first payment from a licensee, a new profile is created for the licensee. If the licensee has previously paid royalties, then the payment is entered under the existing profile. Where licensees operate under more than one statutory license, the royalty payments from a licensee are allocated among the various licenses under which the service is operating. Similarly, where one parent corporation is paying royalties for multiple corporate "children," such as in the case of a broadcast station group paying for individual terrestrial radio stations simulcasting their signals on the Internet, the royalty payments are allocated among the individual radio stations to the extent the licensee provides sufficient information for the allocation. For example, if a broadcast network provides royalty accounting for its 70 radio affiliates on a per-radio station basis, but pays the royalties owed by all of the affiliates with a single check, then SoundExchange will allocate a portion of that total payment to each of the 70 individual stations. Allocating payments to individual stations is critical for distributing royalties because distribution is based on the performance information in reports of use, which should be submitted on a per-station basis.

Once a licensee has paid royalties and its payment is entered into our database, we also seek to confirm whether the licensee has filed a Notice of Use of Sound Recordings Under

Statutory License with the U.S. Copyright Office. If a service has not filed such a Notice of Use with the Copyright Office, then my understanding is that the service does not enjoy the protections of the statutory license even if they are paying royalties. The filing of a Notice of Use with the Copyright Office does not mean that a service is making transmissions. The Notice of Use is supposed to be filed before a service commences transmissions or the making of ephemeral phonorecords but just because a service files a Notice of Use does not mean it has commenced streaming.

The reports of use (“logs”) provided by services are loaded into SoundExchange’s system by the Distribution Operations Department. SoundExchange is currently receiving performance logs from Music Choice, Muzak, XM Satellite Radio, Sirius Satellite Radio and a handful of other services. The vast majority of subscription and nonsubscription services, however, do not currently provide performance logs to SoundExchange because regulations specifying the format and delivery specifications have not yet been promulgated. The following discussion of log processing is therefore based principally upon SoundExchange’s experience handling logs from preexisting subscription services and the satellite radio services.

Occasionally, logs — which contain text information about the song title, album, artist, label and other information, in addition to other transmission information — will fail to conform to SoundExchange’s existing format and delivery specifications. When a log does not conform to those specifications, it fails to load automatically. SoundExchange personnel must then review the reports, identify errors, obtain a corrected log from the service (or in some cases rectify the errors internally) and then re-upload the reports into the SoundExchange computer software system. The failure of logs to follow a standardized format creates enormous burdens for SoundExchange and decreases our efficiency in managing royalties. It is also frequently the

case that services fail to accurately report identifying data for sound recordings by, for example, identifying an artist as “Various,” reporting a performer as “Beethoven” or “Mozart,” or simply not providing required information. In each of these instances my staff has to research the partially identified sound recording in order to identify accurately the sound recording copyright owner and performers entitled to royalties. It is my understanding that the only penalty that a service may be subject to for failing to file a proper report of use is an infringement action.

Step 2: Matching

SoundExchange’s Distribution Operations staff run the software program to match the data reported in licensee logs with information in the SoundExchange database identifying copyright owners and performers of particular sound recordings. Our complex log loading algorithm attempts to match identical and similar data elements and combinations of data elements from the incoming log against performance information previously received from the services. If there is a match for a particular sound recording, then the program identifies the corresponding copyright owner and performer information. If there is not a match, we then conduct research as described in step three below.

Each description of a performance on a service’s log is retained in our database, even if the description incorrectly identifies a sound recording and SoundExchange staff has corrected it before uploading the log. Our system assumes that services will continue to report the performance incorrectly in future logs. Rather than correct these performances each time they appear in a log, the system matches to the incorrectly reported performances and then applies the corrected information.

Step 3: Research

If there is no match for a sound recording, Distribution Operations personnel manually examine the entry for the sound recording and attempt to determine whether it is new to the



SoundExchange database or whether it is already in the database under different identifying information. This research requires a significant amount of staff time. Such research is often required for new releases, works reported for the first time, works from small labels, compilation albums and foreign repertoire. In the case of compilation albums, for example, finding copyright ownership information is particularly time-consuming because, although the album is issued by one label, each of the sound recordings on it could be owned by a different label.

SoundExchange previously identified the problem of compilation albums in its filings with the Copyright Office on notice and recordkeeping. *See* Reply Comments of the Recording Industry Association of America, Inc., in Docket No. RM 2002-1A at 57058, 60 (Apr. 26, 2002) (SX Ex. 414 DP); *see also* Comments of the Recording Industry Association of America, Inc., in Docket No. RM 2002-1A at 64 (Apr. 5, 2002) (SX Ex. 415 DP).

SoundExchange conducts extensive data quality assurance work to ensure the correct association of copyright owners and performers, on the one hand, and particular performances, on the other. For example, the SoundExchange system detects what we call “performances in conflict,” a situation in which performances of the same sound recording are reported as being on more than one label. In such cases, we conduct research to determine the correct label for the sound recording. We also review situations in which an artist has performances of different sound recordings with different labels or with “unassociated labels,” which may indicate that the label information provided to us was incorrect.

#### Step 4: Account Assignment

SoundExchange’s Account Managers assign sound recording performances to accounts belonging to copyright owners and performers. For example, a performance of Stevie Wonder’s *Isn’t She Lovely* from his *Songs in the Key of Life* album under the Motown record label (part of Universal Music Group (“UMG”)) would be assigned to (1) Stevie Wonder’s account and

(2) Motown's account. Performances of Motown's sound recordings would be consolidated with other UMG labels and the resulting royalty payment would be made to UMG. Account assignments are based on the copyright owner and performer information provided by the licensee as well as any information already in the SoundExchange database that copyright owners and performers have supplied.

Not all performances can be assigned to a copyright owner or artist account in the time leading up to a distribution. Performances for which a copyright owner or artist account is not identifiable are assigned to a "suspense" account for later review and research. As soon as the identification is made, these royalties are released in the next scheduled distribution.

#### Step 5: Royalty Allocation and Distribution

Once we have processed all of the logs by a given class of services for a given period, we are able to allocate royalties. Allocation takes place only after all quality assurance steps are taken to ensure accounts are payable, address and tax identification information is complete, performances in conflict are resolved and copyright owner conflicts are resolved (to the extent possible).

Allocation is the process by which a service's royalty payments (made on a channel-by-channel or station-by-station basis) for a given distribution period are paired with the transmissions of sound recordings by that service during that period. The Royalty Administration Department first identifies the services and associated royalty payments that will be distributed. Minimum fees must be prorated to the period to which they apply. Once I have reviewed and certified the prorating of the minimum fees and the amount of the total fees, those fees are entered into the distribution portion of our system. The allocation and distribution processes are then run.

As stated above, allocation pairs royalties collected from a service with the service's sound recording performances. Once all allocations are completed, "adjustment processing" is run. Adjustment processing involves assigning debits and credits to accounts in order to rectify errors that occurred in a prior distribution. Upon completion of necessary adjustments, the distribution occurs.

Distribution begins with consolidating allocations according to earning entity (*i.e.*, the copyright owner or featured artist who has "earned" the money for tax purposes). The consolidated allocations are then assigned to copyright owners, artists or other payees based on the payment schedule for each. SoundExchange staff create a series of distribution certification reports, which I review and then certify. Next, the system generates a payment file, which we transmit to our banking partner. The bank then makes the payments in the form of a check or electronic funds transfer. For performances of sound recordings, 50% of the royalties net of allocable deductions are paid to copyright owners, 45% are paid to featured artists and their third-party payees,<sup>1</sup> and 5% are paid to non-featured artists,<sup>2</sup> in accordance with 17 U.S.C. § 114(g)(2). Royalties paid for the making of ephemeral phonorecords under 17 U.S.C. § 112(e) are allocated solely to sound recording copyright owners. SoundExchange provides each royalty-earning entity with a statement that reflects the performances (and the licenses under which the sound recordings were performed) for which the royalty payment is made. Sample statements for copyright owners and featured artists are attached as SX Exs. 252 DP and 253 DP hereto.

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<sup>1</sup> A third-party payee is an individual to whom an artist has authorized SoundExchange to pay a portion of the artist's statutory royalties. Producers and managers are common third-party payees.

<sup>2</sup> We pay the 5% non-featured artists' share to an independent administrator who is responsible for the further distribution of those funds to nonfeatured vocalists and musicians.

SoundExchange's database containing payee information is derived from account information received from record labels and artists, and includes such payees as the copyright owners and artists themselves, management companies, production companies, estates and heirs. We must, however, verify address and other information and secure appropriate tax forms directly from each artist and label. If an earning entity<sup>3</sup> fails to provide SoundExchange with tax information, then we can still distribute royalties but must withhold a portion of the royalties pursuant to Internal Revenue Service ("IRS") guidelines. All of the information provided to SoundExchange from copyright owners and performers must be entered manually into the royalty system. We hope to allow copyright owners and performers to input their information directly into our systems in the future, but there are costs and security issues involved in building those extensions into our current system.

The threshold for distributing royalties to a payee is \$10. Rather than distribute smaller amounts (and incurring significant additional transaction costs), SoundExchange waits until a payee is owed more than \$10, at which point the full amount is distributed.

SoundExchange presently conducts distributions four times a year, at least twice for statutorily licensed performances (*i.e.*, performances pursuant to 17 U.S.C. §§ 112(e) and 114) and twice for non-statutorily licensed performances for which SoundExchange has collected royalties, typically from non-U.S. performing rights organizations who have money for U.S. performers or copyright owners. We are working to increase the frequency of distributions. Payments for which SoundExchange lacks sufficient information to distribute to the appropriate copyright owner and performer are allocated to separate accounts in accordance with 37 C.F.R.

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<sup>3</sup> An "earning entity" is the person or entity who has earned the royalties from a tax standpoint and does not have to be the person who receives royalties.

§§ 260.7, 261.8 and 262.8. When SoundExchange subsequently obtains the information necessary to distribute royalties to a particular copyright owner or performer, it will do so during the next scheduled distribution. Recipients of royalty payments may contact SoundExchange regarding any perceived errors in distributed payments. Errors in payment distributions may occur as a result of a service's reporting incorrect or incomplete information for a given performance.

Step 6: Adjustments

In the event an improper amount of royalties is paid to an entity (either too little or too much), SoundExchange staff will make adjustments to accounts to correct any errors in a royalty distribution. For example, if Copyright Owner A was incorrectly reported as the copyright owner of Song X and received royalties for Song X, but the actual owner of that song was Copyright Owner B, then SoundExchange would need to credit Copyright Owner B in a future distribution and debit Copyright Owner A's account for the improper distribution. Adjustments typically take the form of an additional payment or a reduced payment to an existing account in the next scheduled distribution. For copyright owners and artists who are newly identified and for whom royalties have been accruing, a new account is created and royalties attributed to the suspense account are transferred to the new account.

C. Challenges Faced by SoundExchange

While these operational steps may sound straightforward and although SoundExchange has gained tremendous efficiencies through its custom software system, the massive scope of the undertaking and the frequency with which novel circumstances arise render the actual task of collecting and distributing royalty payments extremely complex. SoundExchange maintains licensee accounts for more than 1,800 webcast, cable, and satellite services that play sound recordings originating from all over the world, in many cases twenty-four hours a day, seven

days a week. SoundExchange distributes royalties to nearly 15,000 copyright owner and performer accounts. To date, SoundExchange has processed over 650 million sound recording performances. And it is important to remember that those 650 million performances are principally from the preexisting subscription services and the satellite services. That number will increase tremendously once reporting regulations are finalized for the subscription and nonsubscription services for whom rates are being established in this proceeding. I would not be surprised if we had to match billions of performances each year once all webcasters start providing reports of use.

The process of matching performances of specific sound recordings to individual copyright owners and performers is often difficult because many business arrangements in the recording industry are intricate and continually evolving. For a given sound recording, there may be multiple artists as well as multiple payees entitled to receive a portion of the royalties, including production companies and management companies paid under Letters of Direction, as well as the IRS. Further, members of a band often change over the course of the band's existence.<sup>4</sup> When a band whose members have changed releases multiple versions of the same song, each release may involve payments to different people. Matching the performing band members to a particular sound recording of such a song can be complicated. The make-up of the Grateful Dead, for instance, changed several times during the three decades that the band played (1965 to 1995, when Jerry Garcia died), and the band regularly released studio albums and live albums (and it continues to release "new" recordings from its vault of concert tapes). Because

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<sup>4</sup> The examples of band compositions that make distribution of royalties difficult illustrate a few reasons why sufficient data to identify a specific sound recording is critical to SoundExchange's ability to distribute royalties to the parties to whom they rightly belong, as SoundExchange explained in its Supplemental Comments concerning the proposed notice and recordkeeping requirements. Comments *(footnote continued on next page)*

the membership of the Grateful Dead was not static, identifying which members are entitled to royalties for performances of a particular sound recording is exceedingly difficult where the same titled song appears on multiple albums. Fleetwood Mac similarly has undergone multiple changes in membership since it originally formed in 1968, making the task of determining which royalties belong to which members arduous. And Sade is the name of both the individual artist Sade Adu and the band with which she has sung. When SoundExchange receives reports from licensees that list only "Sade" as the performing artist, it can be difficult to determine whether Sade Adu or Sade the band is the proper recipients of royalties for a sound recording performance.

Band members may also share royalties on an unequal basis. In the easy case, bands or artists have a corporation that receives the royalties and the corporation assumes responsibility for dividing and distributing royalties among the band members. In some cases, however, SoundExchange itself has to locate the information regarding shares, divide the royalties, and make the payments to each band member.

The general rule we have created is to distribute royalties on a pro rata basis among the members of a band, but that is not always as easy as it may sound. For example, there is no guidance in the statute or legislative history on how SoundExchange should distribute royalties to Tom Petty and the Heartbreakers. Is Tom Petty entitled to 50% of the featured artist share with the remaining 50% allocated on a pro rata basis among the members of the Heartbreakers? Similarly, should there be a special split for the Dave Matthews Band, where the name of the band is the name of one of the members of the band? And what about in the case of Diana Ross

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of SoundExchange in Docket No. RM 2005-2 (Aug. 26, 2005) (SX Ex. 417 DP); Reply Comments of SoundExchange in Docket No. RM 2005-2 (Sept. 16, 2005) (SX Ex. 418 DP).

& the Supremes versus The Supremes? In one instance Diana Ross is identified separately, but does this mean her share of royalties should increase?

Distributions are also complicated if an artist is deceased and there are multiple heirs (each of whom may have a different share) entitled to the royalties from the performance of a single sound recording; this is particularly true where the artist is a group and more than one group member is deceased.

Distributions could become far more complicated if the members of a band were represented by different agents, with one member of a band represented by one collective and all remaining members represented by SoundExchange. Under the theory of certain entities, the members paid through SoundExchange would receive less than the members paid through another entity due to the possibility of others free riding on SoundExchange's investments without having to share in the cost of those investments. And, if there were multiple collectives, then the difficulties associated with allocating royalties and deducting costs could be exacerbated, as explained in more detail below. *See infra* at 16.

In an effort to maintain accurate information on artists' arrangements for division of royalties as well as basic contact and tax information, SoundExchange actively engages in artist outreach. SoundExchange regularly attends music industry conferences and makes presentations to artist management firms, record labels, performing rights organizations and law firms that represent artists. SoundExchange also works with music associations to spread awareness of its services, and it advertises online, on television, in print and over the radio. SoundExchange personnel are available to artists (as well as to copyright owners and licensees) to provide information and answer questions, and we do so on a regular basis. SoundExchange encourages copyright owners and performers to join as members but, as explained above, provides



information and distributes royalties to copyright owners and performers regardless of membership.

For undistributed royalties, eight SoundExchange staff members' responsibilities include conducting research to locate artists and obtain their payee information. Even where SoundExchange is able to determine the identity of the artist and record label, that does not mean that SoundExchange knows where to locate them. Locating accurate payee information for a sound recording can be very difficult, especially if the recording is listed in a non-active, deep "catalog," or involves an artist who does not have a U.S. corporate entity designated to receive royalties on his or her behalf. Through niche programming, services perform many sound recordings of smaller, less well-known labels and performers who are hard to find (and the problem is magnified if they are no longer in existence). SoundExchange spends a significant amount of time addressing this problem in two ways. First, SoundExchange personnel publicize the organization, its mission, and its functions in order to ensure that artists and copyright owners are aware that they may have royalties owed to them. We hope that individuals who learn about us will contact us to provide us with the information we need to pay them. Second, SoundExchange performs extensive research to locate and contact individuals who may be entitled to royalties. For example, we rely on databases such as Celebrity Access and All Music Guide as well as information provided by other organizations within the music industry, both domestic and foreign, to locate artists. SoundExchange also utilizes temporary employees and interns to assist in locating individuals and entities entitled to royalty payments. I suspect that the number of "difficult-to-pay artists" and labels will increase tremendously once webcasters start providing reports of use to SoundExchange following the promulgation of format and delivery specifications.

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Under my direction, SoundExchange has conducted a total of nine royalty distributions covering over 650 million sound recording performances, the most recent having occurred on September 20, 2005. To date, SoundExchange has allocated more than \$55 million in royalties. SoundExchange strives to minimize the administrative costs associated with royalty collection and distribution, and it has decreased those costs each year that it has been in operation. SoundExchange maintains a staff of fewer than 20 individuals. We project administrative costs (exclusive of expenses incurred in participating in rate adjustment proceedings) of under 12.5% of total revenue for 2005 and under 10% of total revenue for 2006. For comparison purposes, I believe the administrative costs for the American Society of Composers, Authors and Publishers (“ASCAP”) and BMI are typically around 16% of total revenue.

## **II. A SINGLE COLLECTIVE SHOULD BE DESIGNATED TO COLLECT AND DISTRIBUTE ROYALTIES**

As a practical matter (and generally as a legal matter as well), SoundExchange (or its precursor) has operated as the sole collection and distribution agent for royalties under the Section 112 and 114 licenses. Other than Royalty Logic, Inc. (“RLI”) and the small number of copyright owners and performers it purports to represent, I am not aware of any copyright owner or performer — let alone any service — who will advocate for the creation of a multi-tier system for collection and distribution of royalties<sup>5</sup> or for the designation of multiple agents.<sup>6</sup> In fact, the licensee webcasters appear to object to the creation of a multi-tiered system or any

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<sup>5</sup> Under a multi-tier system, SoundExchange would be required to collect royalties and then transfer them to another agent that has been designated by a copyright owner or performer to distribute its royalties. Allocations would need to be run to determine what portion of collected royalties should be paid to another agent who may represent only one copyright owner or performer.

<sup>6</sup> Under a multi-agent system, licensees could have to make their royalty payments to different agents according to the designations made by copyright owners and performers.

obligation to provide payments and reports of use to any entity other than SoundExchange. *See* Joint Comments of Radio Broadcasters in Response to the Copyright Royalty Board's Supplemental Questions Regarding Format and Delivery in Docket No. RM 2005-2 at 23 (Aug. 26, 2005). This is true even though the large commercial webcasting services in the first webcaster proceeding presented Ron Gertz, the owner of RLI, which purports to be a competing collection and distribution agent, as a rebuttal witness on their behalf. If the services are not supporting the creation of a multi-tiered system and the overwhelming majority of copyright owners and performers, as represented by SoundExchange, oppose such a system, I question how such a system could be created under the willing buyer/willing seller standard set forth in the statute.

I discuss the problems associated with a system that includes more than one collection and distribution agent because I anticipate that RLI will raise the issue in this proceeding. If a system were created to allow for at least two collection and distribution agents, then I question how the rationale could be applied to limit the number of agents to two. If each copyright owner or performer had the right to designate his/her own agent, then the Board would potentially have to allow an unlimited number of collection and distribution agents to collect and distribute royalties. *See id.* If this were the case, then there would be an incentive for copyright owners and performers — even SoundExchange's members — to designate agents other than SoundExchange so that they could avoid certain costs that SoundExchange incurs for the benefit of all copyright owners and performers and shift those costs to the copyright owners and performers remaining with SoundExchange. Adding multiple distribution agents to the process would substantially increase the administrative costs SoundExchange already incurs, as explained in more detail immediately below, and the result would be substantially increased

overall administrative costs associated with the royalty collection/distribution process. Thus, a multi-agent system would appear inconsistent with the concept of an efficient licensing system whose costs are borne by all copyright owners and labels.

The purpose of the royalty collection and distribution process is “to make prompt, efficient and fair payments to Copyright Owners and Performers with a minimum of expense.” 67 Fed. Reg. 45,240, 45,267 n.46 (July 8, 2002) (SX Ex. 407 DP). Each of SoundExchange’s procedures that I have outlined above is designed to further this purpose. The Librarian of Congress has recognized that “Copyright Owners and Performers commend Sound Exchange . . . [and prefer it as] a non-profit organization that has already invested heavily in a system designed to locate and pay Copyright [O]wners and Performers.” *Id.* at 45,267. Indeed, through our five years of experience collecting and distributing royalties and our substantial investments in recruiting and training the SoundExchange staff and in developing our custom computer software system, we have developed an efficient process for prompt and fair payments.

Much of that efficiency would be lost if additional agents were inserted into the collection and distribution process. The Librarian was right to express skepticism of a system involving more than one collection or distribution agent on the grounds that it would likely add unnecessary expense and administrative burden. *See id.* A multi-agent system would be costly, overly complicated, prone to delay and unreliable.

Based on previous discussions with outside software consultants, other collecting societies as well as my staff’s and my experience with adjustments, conflicts in ownerships and claims and dispute resolution (to track the affiliations of each copyright owner and performer on a sound recording-by-sound recording basis), I estimate that modifying our systems to accommodate a multi-agent system would cost, at a minimum, between \$250,000 and \$350,000.

For example, if only one member of a band were represented by someone other than SoundExchange, then SoundExchange's system would have to be modified to track that relationship.<sup>7</sup> If different administrative rates were to be applied to copyright owners or performers represented by an entity other than SoundExchange, the system would also have to be configured to calculate different administrative rates for each sound recording in the database. Given that each performance has at least two entitled payees (exclusive of the non-featured share of royalties) – (1) the featured artist (which could be a group with multiple entitled parties) and (2) the copyright owner – each of the copyright owner and the featured artist could be represented by a different distributing agent. A multi-agent system thus has the potential of requiring SoundExchange to account for every performance identified in a report of use multiple times in order to properly allocate, distribute and adjust royalties. This would not be an easy task, and it would place an enormous accounting burden on SoundExchange.

SoundExchange's system presently contains entries for 150,000 copyright owners and performers<sup>8</sup> and over 700,000 sound recordings. For the system to recognize multiple agents, SoundExchange would have to expend significant resources, both human and monetary, to create the accounting platform necessary to track innumerable distributing agent relationships, keep accounts current when entitled parties change affiliation with multiple agents, and still ensure timely distributions.

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<sup>7</sup> Lester Chambers, a member of The Chambers Brothers, previously expressed an interest in having RLI collect and distribute royalties on his behalf. As the default agent, however, SoundExchange would collect and distribute royalties on behalf of all the other members of The Chambers Brothers.

<sup>8</sup> For example, Paul Simon as a solo artist and Simon & Garfunkel as a group are two such performers of the 150,000 even though Paul Simon may receive a single check for all of his performances as a solo artist and as a member of a group.

Under a two-tier system with SoundExchange as the receiving agent and multiple distributing agents, SoundExchange would have to alter its procedures for processing SOAs and royalty payments. SoundExchange currently processes the two simultaneously because the functions are complementary, thereby minimizing administrative costs, reducing total processing time and limiting the number of staff involved. But, if SoundExchange were not the exclusive distributing agent, it might not be able to release a payment for distribution until it agreed with all other distributing agents that the SOAs for the distribution period were in order. It is foreseeable that situations will arise where another distributing agent identifies as problems entries on an SOA that SoundExchange would not consider problematic. SoundExchange would be restricted from using its discretion when dealing with paperwork that is incomplete, non-standard or otherwise problematic. Instead, it would have to confer with all other agents to reach a consensus on how to manage issues arising with services' SOAs, payments and other required paperwork. Considerable delays in distribution are foreseeable where payments cannot be processed until such issues are resolved. Similarly, if a licensee failed to pay royalties in a timely manner, SoundExchange and the other agents might need to discuss what steps needed to be taken and by whom to ensure the payment of royalties and any late fees due. And, if any late fees were owed and paid, there would be additional accounting to split them among distributing agents.

SoundExchange would also have to alter its system to ensure that adjustments to correct for distribution errors are properly debited or credited to royalty recipients whose affiliation with a particular distributing agent changes over time.<sup>9</sup> SoundExchange would no longer be able to

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<sup>9</sup> In a multi-agent systems, regulations would have to specify how and when a copyright owner or performer may switch designations.

rely on its current procedure of crediting or debiting individual copyright owner and performer accounts, but would have to reach agreement with the other distributing agents on an adjustment system and inter-agent dispute resolution process, which would add further costs and delays. Based upon SoundExchange's prior experiences with RLI, I am not convinced that these issues can be worked out easily. When RLI was granted designated agent status in the first webcaster arbitration it imposed significant delays in the simple matter of designing the SOAs and ultimately did nothing to contribute to the creation and final form of the SOAs. I therefore believe that the regulations governing a multi-tiered distribution system would have to set forth in great specificity all of the steps to be taken to resolve problems, disputes or claims among multiple agents and include a continuing role for the Board to resolve disputes, if any arose, provided that such a role for the Board is permitted under statute.

Another example of how a multi-agent system would complicate the royalty collection/distribution process is the hindrance it would cause to licensees' ability to obtain reliable information about the statutory license. Many licensees and potential licensees rely on SoundExchange staff to answer questions, walk them through the process of complying with the terms of the statutory licenses, calculating royalties owed, and complying with reporting requirements. With a multi-agent system, licensees would not be able to rely on information from the single source of SoundExchange and would likely have to contact multiple agents according to the various affiliations of the copyright owners and performers whose sound recordings they have performed. For example, different agents may have different interpretations of the provisions of a statutory license (*e.g.*, what level of interactivity is permitted, if any, or how should the sound recording performance complement be interpreted for purposes of classical recordings) or governing regulations, and a licensee, to avoid potential

liability for copyright infringement, may feel the need to contact each agent in order to protect itself. Under a multi-tier system with distinct receiving agents and distributing agents, it would be unclear which entity's information would be definitive. The confusion associated with such a system inevitably would add costs and delays not present in a single-agent system, particularly if licensees relied upon information from an agent other than SoundExchange, information which SoundExchange disputed. In the alternative, SoundExchange might still have to field all of these inquiries and incur the expense of providing information to licensees, and other agents could avoid these burdens by referring everyone to SoundExchange, without having to share in any of the associated costs.

A multi-agent system could create problems for distribution policy matters, such as how royalties to orchestras and non-human performers (*e.g.*, Elmo), should be paid, what rules should apply for distributing to bands where there are disputes among band members, etc. Currently, SoundExchange endeavors to develop policies that apply fairly to all interested parties but if each distribution policy decision also has to be worked out with multiple distributing agents — who may disagree with SoundExchange's proposed policies — then many distributions could be suspended or delayed due the inability of the agents to agree on allocation guidelines.

A multi-agent system could also raise problems for enforcement and audits. For example, if the copyright owners and performers represented by other agents claimed that they were not subject to any of the costs incurred by SoundExchange for audits and enforcement, would SoundExchange have to share any recoveries obtained through enforcement or audits with such other collection and distribution agents? I would hope not. If certain entities choose not to share in the costs that are expended for the benefit of all copyright owners and performers, then I do not believe the copyright owners and performers represented by SoundExchange should have



to share any late fees, collection of unpaid royalties or audit recoveries with such entities. But saying this in theory may create problems in practice, particularly when a service remits overdue royalties after receiving a demand letter from SoundExchange. The question of how those overdue royalties should be allocated will likely result in a dispute in a multi-agent environment, particularly where some agents seek to avoid joint costs, but want to share in “joint” rewards.

These examples are illustrative of the added complications, costs and delays that a multi-agent system would create. Further inefficiencies and delays are foreseeable, particularly when disputes among and between potential distributees are considered. Moreover, based on SoundExchange’s experience in collecting and distributing royalties to date, I believe that there likely are additional inefficiencies that are unforeseeable. Each year that SoundExchange has been in operation, I have been confronted with conflicts and complications in the collection and distribution process, some of which I have described above, that neither I nor my colleagues foresaw when SoundExchange began operating. Injecting one or more additional agent(s) into the equation, in my opinion, would likely result in many new conflicts and complications that we cannot predict.

The Librarian of Congress has recognized the natural efficiency of a single collection and distribution agent for royalties associated with digital performance of sound recordings. 63 Fed. Reg. 25,394, 25,412 (May 8, 1998) (“designat[ing] a single entity to collect and distribute the royalty fees creates an efficient administrative mechanism”) (CARP proceeding on digital performance of sound recordings by pre-existing subscription services) (SX Ex. 411 DP). Countries around the world have found that a single agent reduces administrative costs and speeds distribution, and a single collective for receipt and distribution of digital performance

royalties is the international norm.<sup>10</sup> A single agent will best further the purpose of the collection and distribution process — “to make prompt, efficient, and fair payments to Copyright Owners and Performers with a minimum of expense,” 67 Fed. Reg. at 45,267 n.46 — and should be designated for collecting and distributing royalties for the digital performance of sound recordings under Sections 112(e) and 114 of the Copyright Act.

### **III. MODIFICATIONS NEEDED TO LICENSE TERMS**

I am concerned that the terms for the payment of royalties and the terms for recordkeeping, once adopted, may be left unchanged in future proceedings which are likely to focus primarily on royalty rates. SoundExchange’s experience over the past several years demonstrates that a few of the terms found in 37 C.F.R. Part 262 must be modified to facilitate the prompt, fair and efficient administration of the statutory licenses. As explained below, there are a few of the current terms that frustrate SoundExchange’s ability to perform its function. These terms make no sense in the context of the statute’s overall goal of providing fair compensation to artists and record labels. SoundExchange requests that the CRB modify the terms accordingly.

I am assuming for the purposes of my testimony that the general structure of the current system — with SoundExchange serving, in effect, as the sole agent designated to receive and distribute statutory royalties — will continue. If that structure were to change to accommodate multiple collectives, which SoundExchange strongly opposes, then there would likely have to be

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<sup>10</sup>Over 60 other countries — including those with the most sales of sound recordings, *i.e.*, the United Kingdom, Germany, Japan, and Canada — operate under a system in which a single collective collects and distributes royalties. To my knowledge, only Brazil, Colombia, and the United States have competing collectives that receive and distribute royalties for a particular right. In Brazil and Colombia, disputes between collectives often result in royalties that are either delayed or never paid. SoundExchange’s efforts to pay royalties to artists in those countries pursuant to reciprocal payment agreements are often frustrated because of the uncertainties attributable to the multi-collective systems.

substantial revisions to the regulations to account for the complexity of a multi-agent system and how conflicts and adjustments would be made among multiple agents.

A. Importance of Census Reporting

Although recordkeeping requirements are not set forth in Part 262, I do want to briefly reiterate SoundExchange's long-standing request for census reporting. SoundExchange has previously submitted extensive comments on recordkeeping and, in particular, the need for census reporting in response to the Copyright Office's and the Board's notice and requests for comments in connection with their rulemakings on recordkeeping. I incorporate those comments by reference and have attached copies of the most recent Comments (exclusive of attachments). *See* Comments of SoundExchange in Docket No. RM 2002-1H (May 27, 2005) (SX Ex. 416 DP); Comments of SoundExchange in Docket No. RM 2005-2 (Aug. 26, 2005) (SX Ex. 417 DP); Reply Comments of SoundExchange in Docket No. RM 2005-2 (Sept. 16, 2005) (SX Ex. 418 DP); *see also* Reply Comments of the Recording Industry Association of America, Inc., in Docket No. RM 2002-1A at 69-78 (Apr. 26, 2002) (SX Ex. 414 DP). I will not belabor what we have said in those submissions, but I emphasize here that accurate data is critical to the integrity of the collection and distribution process that I have described above. As SoundExchange's comments explain, receiving reports of use in census form and in a uniform format is the only way to ensure that copyright owners and performers receive accurate payments for the use of their sound recordings.

B. The Terms Should State that the Failure to Pay Royalties When Required Followed by Payment of a Late Fee does not Preclude a Copyright Infringement Claim

Statutory licensees are generally required to pay their statutory royalties 45 days after the end of each month. Unfortunately, many licensees fail to pay their royalties in a timely manner.

When a licensee fails to pay royalties when due, they are subject to a late fee of 0.75% per month.

I believe that there was an outstanding question as to whether the inclusion of a late fee provision in the regulations precluded a copyright owner from filing an infringement action against a service that failed to pay royalties in a timely manner. For example, I understood that it might have been possible for a service to argue that, when it was sued for copyright infringement for the failure to pay royalties, the service might have been able to make that litigation disappear if the service simply paid the unpaid liability plus interest. If this were true, then I think there would be a significant incentive for services to not pay royalties in a timely manner, particularly if they could never be sued for infringement and only had to pay a minimal late fee if challenged by copyright owners.

I understand that Congress, in the Copyright Royalty and Distribution Reform Act (“CRDRA”), amended Section 114 to make clear that the inclusion of a regulatory term providing for late fees does not affect a copyright owner’s other enforcement rights. 17 U.S.C. § 803(c)(7) (“A determination of Copyright Royalty Judges may include terms with respect to late payment, but in no way shall such terms prevent the copyright holder from asserting other rights or remedies provided under this title”). So that the terms established through this proceeding clearly reflect the statutory preservation of copyright owners’ remedies for infringement and put licensees on proper notice, I believe the Board should adopt regulations that make clear that a licensee that fails to make royalty payments on a timely basis may be subject to liability for infringement in addition to late fees.

C. The Interest Penalty for Failing to Pay Royalties When Required Should be Increased and Interest Charges Should Accrue After a Demand for Payment

As noted above, licensees are generally required to pay royalties 45 days following the end of the month for which the liability is calculated, but many services fail to meet this deadline. 37 C.F.R. § 262.4(c). Late payments can range from a few days to a few months. In some instances, services have gone several years without paying royalties. We also have experience with a service failing to pay royalties for several years, filing for bankruptcy to have its debt discharged, and then a purchaser of some, but not all, of the assets of the bankrupt licensee claiming to be a successor to the bankrupt entity for one purpose (to benefit from below-market rates) but not for other purposes (with respect to unpaid liabilities).

I do not believe the current interest rate of 0.75% per month is an effective deterrent to ensure that licensees pay royalties when they are due. In comparison, credit card companies that do not receive payments from users by the due date are permitted to charge rates that are significantly higher than the rate charged to webcasters. To ensure prompt payment of royalties, reduce SoundExchange's costs of obtaining payment from licensees, and to create disincentives for licensees to delay payments, I strongly encourage the Board to increase significantly the interest charges to be paid when a service fails to pay royalties when due. I believe increasing the monthly rate from 0.75% to 2.5% would be appropriate.

While some may view a higher interest rate as a penalty, I believe it is better characterized as motivation for those who seek the benefit of the statutory license to actually comply with the provisions of the license. A higher interest rate would also level the playing field between those services that comply with regulations and those that do not. When one combines a low interest rate (0.75%) with the high cost of bringing an infringement action for

failure to pay royalties, it is easy to see that there is an economic incentive for services to pay royalties when they feel like it rather than when the payments are due.

We have had varying degrees of success invoicing services for late fees.<sup>11</sup> Many services pay late fees when requested, which is typically within three weeks from the date we send out a letter requesting payment of late fees. However, there have been occasions where a service has been reluctant to pay interest penalties. We had a recent situation where a licensee received a demand letter for late fees in July 2005, but failed to pay the late fees until October 20, 2005, without being subject to any additional penalties.

To ensure that licensees do not have an incentive to refuse to pay late fees upon receipt of a demand letter from SoundExchange, I would encourage the Board to adopt a regulation that specifically addresses this situation. I propose that when SoundExchange requests the payment of late fees from a service, the service be given a 20-day grace period in which to pay its late fees. The 20-day period would run from the date of the letter or the postmark on the envelope, whichever is later. If a service failed to pay the late fees within the 20-day period, then the late fee amount should be doubled every five days that the late fee amount remains unpaid.

If a licensee makes an intervening payment for a monthly liability while a late fee penalty is still outstanding, the regulations should provide that the intervening payment is first applied to current liabilities and only after those are discharged will any surplus be applied to outstanding

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<sup>11</sup> SoundExchange cannot calculate interest charges until payment is actually received. If a service has failed to pay monthly royalties and we send a demand notice for payment, we alert the licensee to the fact that it will be subject to interest charges but then do not invoice the service for late fees until we receive the unpaid monthly royalties. This is because late fees are calculated by multiplying the amount of royalties actually paid by the late fee rate established in the regulations, dividing that product by 30 (the estimated number of days in a calendar month) to calculate the daily late charge, and then multiplying the daily late charge by the number of days between the due date and received date.

late fees. I believe that only by making the financial penalty for failure to pay late fees significant will copyright owners and performers be ensured of prompt payment.

In order to avoid confusion about when payments are due, I would also encourage the Board to clarify in any regulations that when a payment due date falls on a weekend or federal holiday, that the due date be extended to the next business day. The current regulations provide that payments are due by the 45<sup>th</sup> day after the end of a month, which means that payments not received by the 45<sup>th</sup> day, even if that day falls on a weekend or federal holiday, are arguably late. SoundExchange has voluntarily refrained from charging late fees until the second business day following the 45<sup>th</sup> day after the end of a month if the 45<sup>th</sup> day falls on a weekend or federal holiday. Clarification of this issue would benefit licensees and SoundExchange, and I believe the clarification should be codified in the regulations.

D. Penalties Should Also Apply for Services that Fail to Submit Completed Statements of Account and Reports of Use

Current regulations require services to submit completed statements of account (“SOAs”) at the same time that the service remits payment to SoundExchange. 37 C.F.R. § 262.4(f). Unfortunately, services frequently fail to submit completed SOAs or even any SOA. Because we require SOAs to confirm payments and to allocate royalties, it is critical for us to receive these forms from licensees. There is currently no penalty for failing to submit a completed and signed SOA short of the filing of an infringement action. I expect that copyright owners would be unlikely to file an infringement action against a service that paid royalties but failed to file an SOA, even though this failure creates significant problems for SoundExchange (including the inability to verify whether the licensee has paid the correct amount). I therefore encourage the Board to impose a late fee charge on any service that fails to submit a completed SOA when due.

The late fee should be calculated as if the service had failed to pay royalties when required, even if royalties were paid in a timely manner.

Similarly, I believe late fees should also apply where services fail to submit valid reports of use in a timely manner. Without a financial incentive to comply with regulations, I am afraid that many services will fail to submit their reports of use when required.

E. Licenses' Statements of Account Should be Public

Copyright owners and performers periodically ask SoundExchange for information about royalty payments for particular services' performances of their sound recordings under the licenses established by Sections 112(e) and 114. They want to know details such as how much in royalties they are earning from performances of their work by a given service and whether they are owed royalties that have not been paid. This is the information licensees supply in their SOAs (hereinafter "payment information"). See 37 C.F.R. § 262.4(f). The current regulations nevertheless contain a confidentiality provision that precludes disclosure of SOAs even to copyright owners, performers and SoundExchange Board Members who are copyright owners or performers. 37 C.F.R. § 262.5. While copyright owners and performers may receive information about royalties in aggregated form from SoundExchange, *i.e.*, the total amount of royalty payments they receive for a given distribution period, 37 C.F.R. § 262.5(c), they are precluded from obtaining information about specific services' royalty payments, 37 C.F.R. § 262.5(d).<sup>12</sup>

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<sup>12</sup>By contrast, the Copyright Act provides for copyright owners to receive notice of the use of their sound recordings. 17 U.S.C. § 114(f)(4)(A) (directing the Copyright Royalty Judges to "establish requirements by which copyright owners may receive reasonable notice of the use of their sound recordings"). The Copyright Office has rejected the claim that reports of use should be kept from copyright owners based on a theory that services have a proprietary interest in prohibiting the disclosure of their playlists. 63 Fed. Reg. 34,289, 34,295 (June 24, 1998) (concluding, in announcement of interim notice and recordkeeping requirements for pre-existing subscription services, that copyright owners must have *(footnote continued on next page)*)



Licensors copyright owners and performers need payment information for several purposes. When a given service has failed to comply with a license by not paying royalties, copyright owners need details concerning the non-payment in order to make an informed decision about what action to take. They need to know how much in royalties a given service owes (*i.e.*, how much money is at stake), how frequently they pay late, and how overdue the payments are in order to decide whether a copyright infringement suit would be economically justified. For example, it might not make sense to spend thousands of dollars on an infringement action if a service had typically been paying a few hundred dollars a month and then went three or four months without paying any royalties. Conversely, if a service had been paying royalties of tens of thousands of dollars a month and then stopped paying, copyright owners might be more willing to initiate litigation against the service. By the same token, licensors need to know how far in arrears a service is in order to gauge what action is appropriate; one or two months in arrears may warrant measures less severe than if the service were six or more months in arrears.

Copyright owners also request payment information for budget purposes. They want to include estimates of incoming royalties in their revenue projections. They also need this information when they are negotiating collectively with licensees. Licensee services have occasionally directed SoundExchange to disclose details about their royalty payments to their outside counsel, but then refused to allow similar disclosure to sound recording copyright owners. I simply do not understand why the owners of the sound recordings transmitted under

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access to reports of use after weighing services' confidentiality interests against copyright owners' interest in receiving the reports as well as the services' own interest in minimizing administrative costs). Services that transmit sound recordings pursuant to Section 112(e) or 114 by definition transmit them publicly, and the playlists that they have performed are "historical fact." *Id.*; see also Unif. Trade Secrets Act § 1(4) (1985) (defining "trade secret" to mean information that "derives independent economic value, actual or potential, from not being generally known to, and not being readily (*footnote continued on next page*)

statutory license should not have information on services' use of their sound recordings. It is my understanding that in their direct licenses (*i.e.*, licenses negotiated in the marketplace rather than established by statute), copyright owners receive detailed information on the usage of their recordings by licensees. *See, e.g.*, Testimony of Steve Bryan (Warner Music Group); Testimony of Mark Eisenberg (Sony BMG); Testimony of Ken Parks (EMI); Testimony of Larry Kenswil (Universal Music Group) (submitted herewith as part of SoundExchange's direct written case), Simply because a service takes advantage of a statutory license rather than a direct license — when the same recordings are being transmitted or distributed — should not preclude a copyright owner from learning about the uses of his/her/its product and revenue derived from such use.

Copyright owners and performers have also asked for payment information in the context of bankruptcy proceedings, for use in determining what action to take, if any, concerning royalties owed by a service that has filed for bankruptcy. SoundExchange's inability to disclose information on a bankrupt service has hindered its ability to work with its copyright owner members on royalty collection strategies. In addition, where regulations preclude us from disclosing information to individual copyright owners, those owners are themselves handicapped if they wish to file their own claims in the bankruptcy proceeding but lack sufficient information to file a proof of claim.

The current regulations, by precluding SoundExchange's disclosure of licensee-specific information to individual copyright owners, fail to recognize that SoundExchange itself likely lacks an independent cause of action against a service that fails to pay royalties. My understanding of the law is that, in order to file an infringement action, only the owner or

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ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy”).

exclusive licensee has standing. SoundExchange, when granted specific rights by copyright owners, is only a non-exclusive licensee, and when it is acting on behalf of non-members, it likely would not have any right of enforcement. Therefore, current regulations limit payment and financial information to the agent that has no rights to pursue a claim to unpaid royalties, and precludes disclosure to the principals that do have enforceable rights. This situation strikes me as absurd and unworkable.

In addition, SoundExchange needs to be able to share payment information with its Board of Directors, all of whom are either copyright owners or performers. SoundExchange Board Members need full information about the royalties that the organization is responsible for collecting and distributing in order to make informed policy and operational decisions. Decisions on enforcement actions (which are funded from royalties), budgeting, and other Board responsibilities, are dependent upon the ability to review information about royalty payments. Moreover, it is an odd situation to be prohibited by regulation to disclose relevant and material information to my Board.

SOAs should be available not just to copyright owners and performers, but to the public as well. Much of the information about services' statutory activities — *e.g.*, the number of listeners or tuning hours — is publicly reported by industry analysts such as Arbitron. I understand that services voluntarily supply that information to the analysts and then attempt to capitalize on the analysts' reports for their own benefit. SoundExchange, by contrast, is not permitted to disclose to the public the information that it possesses on streaming services' activities, which could contradict the information being reported by third parties or the services themselves. The terms for the Sections 112(e) and 114(d)(2) licenses should not provide

services with the ability to restrict disclosure of information about their operations to instances where only they benefit from the disclosure.

I have not heard any public policy justification for allowing payment information from statutory licensees to be kept from the public generally or from copyright owners, performers and SoundExchange Board Members (who are themselves representatives of copyright owners and performers) specifically. Comparable information concerning other statutory licenses, *e.g.*, the Section 111 license for cable television systems and the Section 119 license for satellite carriers, is filed publicly. I have attached to my testimony as SX Exs. 259 DP - 264 DP sample statements of account filed by cable television systems and satellite carriers — which specify the licensees' royalty payments for the statement period and are available to the public at the Copyright Office. I do not believe there is a basis to conclude that simply because licensees deposit their SOAs with SoundExchange rather than the Copyright Office the information they report should be kept confidential.

Services benefit greatly from being able to transmit all of their royalty payments to a single collective agent rather than having to deal with copyright owners and performers on an individual basis.<sup>13</sup> Licensors rather than licensees pay for that convenience in the form of reduced royalty payments, as SoundExchange's administrative costs come out of the royalties licensees pay. This benefit to licensees should not come at the further price of licensors' inability to obtain information that they would have if services paid royalties and reported directly to them. Because the licenses are public in nature, copyright owners and performers,

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<sup>13</sup>If the arguments of RLI for a multi-agent collection/distribution system are accepted, services might be required to provide reports of use directly to an unlimited number of agents for copyright owners and agents. If such a system were adopted, it would make no sense for an unlimited number of agents to receive information from licensees without that information also being made available to the principals of those agents.

their representatives and the members of the Board of SoundExchange should be entitled to receive all of the information that the services deliver to SoundExchange. If the services do not want to have this information disclosed publicly, then they have the right to seek a direct license from individual copyright owners. If the services believe that payment information is too sensitive for public disclosure, then they should have to at least negotiate over that right at arm's length rather than having federal regulations grant them protections that do not serve the public interest.

The terms adopted in this proceeding therefore should not include confidentiality limitations on the SOAs submitted by licensees, and SoundExchange should be permitted to make such information available to copyright owners, performers, its Board and the general public.

F. The Regulations Must be Modified to Facilitate Prompt and Efficient Verifications of Royalty Payments from Licensees

Current regulations provide for the verification of SOAs and accompanying royalty payments. 37 C.F.R. § 262.6. SoundExchange's experiences with an analogous provision that applies to preexisting subscription services, 37 C.F.R. § 260.5, indicates that the regulations on verifications<sup>14</sup> should be modified in the following respects:

1. The regulations should be clarified so that it is clear that the verification is to confirm the information reported on a SOA. All information necessary to verify the data reported on a

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<sup>14</sup>I intentionally use "verification" rather than "audit" because I understand that the word "audit" may have specific meaning to accountants. I have been told that an audit generally refers to the fairness of a company's financial statements, which is much more extensive an inquiry than what SoundExchange and copyright owners and performers may want, which is an examination or verification of the calculation of royalty payments due from a service. I therefore believe the regulations should refer to verifications or examinations rather than an audit.

SOA, including financial records, computer server logs, etc., should be subject to the verification procedure set forth in Section 262.6.

2. Section 262.6 provides that only the Designated Agent, SoundExchange, is permitted to conduct a verification. This provision is the result of negotiations that took place during the first Webcaster arbitration (in 2001) and would appear to deprive copyright owners and performers — the entities entitled to royalties — of substantial rights. Specifically, I do not understand why a copyright owner or performer should be denied the right to verify royalty payments if SoundExchange, for its own business reasons, decides not to conduct a verification. For example, the copyright owner or performer of a niche genre of music may wish to verify the payments from a service that plays music from that niche, but SoundExchange, for legitimate and sound business reasons, may decide that a verification of that niche service does not make economic sense. Should the owners and performers of that music be deprived of the right to verify payments from the service because of SoundExchange's reluctance? I do not believe that is fair or appropriate, and I request that the Board modify the regulations so that all interested parties may conduct a verification of a statutory licensee's SOA. Such a change would be consistent with the provision found in Section 260.5(g) of the Copyright Office's regulations. 37 C.F.R. § 260.5(g).<sup>15</sup>

3. The language of Section 262.6(b) — allowing SoundExchange to conduct a single verification of a licensee “during any given calendar year, for any or all of the prior 3 calendar years” — may have appeared straightforward when it was drafted by lawyers, but in practice it

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<sup>15</sup>Section 260.5(g) provides: “[F]or the purposes of this section, interested parties are those copyright owners who are entitled to receive royalty fees pursuant to 17 U.S.C. 114(g), their designated agents, or the entity designated by the copyright arbitration royalty panel in 37 CFR 260.3 to receive and to distribute the royalty fees.” I believe performers should also be deemed interested parties now that they have been granted a right for direct payment. *See* 17 U.S.C. § 114(g)(2)(D).

has caused confusion. For example, if SoundExchange files a notice of intent to verify payments in December 2005, I think the provision allows SoundExchange to verify the years 2002, 2003 and 2004, even if the actual work will not begin until 2006, but there is at least an argument that 2002, 2003 and 2004 are not the three years prior to 2006, the year in which the work will actually take place. I think the regulation should make clear that the notice of intent to verify the payments of a service covers the three-year period prior to the year in which the notice is given, even if the audit work does not occur until an even later year. From SoundExchange's perspective, it would be better if the regulations allowed a verification of the year in which notice of intent to verify is given and/or any of the three prior years, provided that no year may be subject to an audit more than once.

4. Section 262.6(c) requires SoundExchange to file with the Copyright Office a "Notice of Intent to Audit." While I think I understand why this is required (to allow other potentially interested parties to have knowledge of the verification in case they want to also participate), I question whether this provision as drafted makes sense. For example, although the regulation requires the notice, it does not explain what happens after the notice is filed. SoundExchange has to file the notice and then the Copyright Office has to publish it within 30 days, but does this mean that the verification cannot commence until after the 30-day period runs? Can the verification commence immediately following publication of the notice in the Federal Register or must there be some additional delay? Also, what happens if other parties want to participate in the verification; what precisely would be the respective rights and responsibilities of the different parties participating in the verification?<sup>16</sup>

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<sup>16</sup>And, as noted above, in a multi-agent system, you could have one agent conducting a verification that the other agents refuse to pay for, but then have those non-paying agents seek to share in any recoveries. This is an example of why a multi-agent system does not make sense when you are talking about a  
*(footnote continued on next page)*

I view this language as vague, and we at SoundExchange have had to guess as to how long to wait after filing a Notice of Intent to Audit to commence the verification. This ambiguity should be clarified or the provision should be stricken and each interested party should have an independent right to conduct a verification regardless of whether any other party had previously conducted a verification.

5. Section 262.6(c) also requires that an “audit . . . be conducted by an independent and qualified auditor identified in the notice.”<sup>17</sup> The regulations, however, do not specify what independent means. For example, SoundExchange has used one company to conduct a verification where some of the principals of the company have acquired copyrights to both musical works and sound recordings. I understand that this practice is not unusual in the music industry where auditors frequently understand the value of copyrights based on their work and consequently buy copyrights as investments. But the ownership of unrelated sound recording copyrights should not preclude a person or entity from being deemed independent.

The provisions of Section 262.5(d)(2) also use the language of “independent and qualified auditor.” It is my understanding that the proper interpretation of that language is also the interpretation that makes the most sense given the regulation’s objective, *viz.*, that the independence of an auditor goes more to whether the person or entity is independent of the licensee that is the subject of the verification, not independent vis-à-vis the licensor that has requested the verification. Someone whose rights are potentially infringed by a service’s failure

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statutory license, where all copyright owners and performers should share in the costs of securing benefits for everyone.

<sup>17</sup>I do not understand why an auditor has to be identified in the notice. If for some reason SoundExchange needed to switch auditors after an initial selection and publication in the Federal Register, SoundExchange should not have to file a new notice with the Copyright Office and await another publication in the Federal Register.



to calculate and pay appropriate royalties should certainly have the right to conduct a verification. I therefore believe that the verification provision should be amended so that it is clear that the independence of an auditor means independence from the licensee and not the requesting licensor.

6. Those entitled to verify the payments from a service also should not be limited to individuals who are Certified Public Accountants ("CPAs"), as CPAs are more expensive than non-CPAs. This would needlessly increase costs, particularly to smaller entities who may wish to audit a service. It is my understanding that in the music industry, non-CPAs (such as business managers and other professional representatives of copyright owners and artists) frequently conduct verifications on behalf of artists, and I see no reason why that practice should not be applied under the statutory license. The scope of who is qualified to conduct a verification therefore should be expanded in both Sections 262.5(d)(2) and 262.6(c) to include non-CPAs.

The regulations should also make clear that a qualified individual does not mean only one experienced in interpreting financial books and records. In many instances a verification of statutory liability will require an ability to interpret server logs to determine whether performances or aggregate tuning hours were properly reported. I therefore believe the regulations should allow verifications by individuals who are competent to determine whether a service has properly calculated its statutory liability.

7. Finally, Section 262.6(g) requires the party conducting the verification to pay for the costs of the verification unless the underpayment by a licensee is determined to be 10% or more of the actual liability. I believe this threshold of 10% is too high and creates an incentive for services to underpay their statutory royalties. At a 10% threshold, services could have an incentive to underpay by 9%, knowing that the only likely consequence is an obligation to pay

the underpayment (excluding for the moment the possibility of an infringement action). This does not seem justified. Services are in sole possession of the information necessary to calculate their royalty payments and they should have to bear the risk of paying for a verification if they underpay by 5% or more. The lower the threshold for burden shifting, the greater the likelihood that services will accurately calculate their liability. Shifting the costs of verifications to SoundExchange or sound recording copyright owners or performers who do not have the right to refuse to license a service — even one with poor credit or a poor history of payment compliance — seems inappropriate. I therefore encourage the Board to reduce the threshold in Section 262.6(g) to 5%.

G. The Regulations Should Authorize the Collection of Refunds in the Event of Incorrect Distributions

I understand that when the Copyright Office makes partial distributions of royalties under Sections 111 and 119 it requires the Phase I claimants to sign a document that obligates them to refund money to the Copyright Office in the event a Phase I claimant receives royalties in excess of the amount finally determined to be allocable to them. A copy of such a document is attached hereto as SX Ex. 265 DP. I believe the regulations adopted in this proceeding should establish a similar rule – obligating copyright owners and performers who receive a distribution in excess of the amount to which they are entitled to refund such monies to SoundExchange, upon written demand.

As noted above, there are instances where an incorrect amount of royalties is distributed to copyright owners and performers. In most instances, the incorrect distribution amount will be adjusted in a subsequent distribution. But, if the amount of an incorrect distribution is too large, it may take an extended period of time for the incorrect distribution to be fully recovered. So as not to harm entitled parties or reward those who received an improper distribution, I respectfully

request that the Board include a regulation that requires the repayment of royalties in the event of an improper distribution. Such a regulation will ultimately benefit all copyright owners and performers and ensure that only those who are entitled to royalties ultimately receive them.

H. No Waiver of Rights from SoundExchange's Acceptance of Royalty Payment

SoundExchange has heard that certain services have argued that because they have paid statutory royalties to SoundExchange and SoundExchange has accepted such payments, the copyright owners and performers represented by SoundExchange have waived the right to argue that the service is making transmissions not eligible for statutory licensing. I believe this argument has no legal merit, but it does call for clarification in the regulations.

In light of the large number of services that can pay royalties to SoundExchange and SoundExchange's limited staff and resources, it is simply impossible to expect SoundExchange to evaluate each service's eligibility for statutory licensing for every month that the service pays royalties. Moreover, because SoundExchange collects royalties on behalf of all copyright owners and performers, not simply those who have specifically authorized it to serve as an agent, SoundExchange does not necessarily have the authority to reject royalty payments on behalf of those copyright owners for whom it does not have written authorization. In addition, different copyright owners may have different opinions as to whether a particular service or functionality is eligible for statutory license. Also, SoundExchange likely does not have the right to file an infringement action. For these reasons, SoundExchange's acceptance of statutory royalties should not be deemed a waiver of the rights of any copyright owner.

I believe language similar to that found in the disclaimer that SoundExchange has posted on its website — "SoundExchange's acceptance of a service's payment does not express or imply any acknowledgment that a service is in compliance with the requirements of the statutory licenses. SoundExchange, its members and other copyright owners reserve all their rights to take

enforcement action against a service that is not in compliance with those requirements” — should be codified in regulations so that all services are aware that SoundExchange’s acceptance of payment from a service does not waive the rights of any of the copyright owners on whose behalf SoundExchange is accepting royalties, whether as an express agent or a default agent. [http://www.soundexchange.com/licensee\\_home.html](http://www.soundexchange.com/licensee_home.html).

I. Transmission of Recordings of Comedic Performances Should be Clarified as Compensable

I am aware of at least two services that are making transmissions of copyright sound recordings of comedic performances. SoundExchange also has received inquiries from representatives of comedic performers about whether statutory licensees are paying royalties for the public performance of these non-musical work sound recordings. This is an issue that admittedly has not received a great deal of attention from SoundExchange, copyright owners or licensees, but it is important because of its impact on comedic performers.

I suspect that the services transmitting comedic performances are likely making such transmissions from sound recordings and not the audio portion of an audiovisual work. So that the performers on comedic works are compensated for the transmission of their works, I believe the regulations should specify that the transmission of such recordings are compensable. I also believe such works should not be classified as “talk” programming (*e.g.*, news, talk, sports or business programming), which in my mind refers to live programming and not programming specifically recorded for release to the public on a CD or in digital form.

J. Provisions Providing for Successor to SoundExchange Should be Deleted

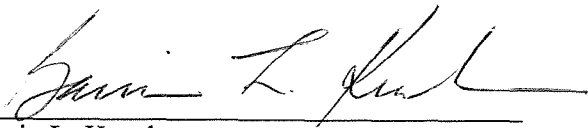
Section 262.4 of the current regulations contains detailed provisions as to what should happen if SoundExchange is not incorporated as a separate entity, dissolved or ceases to be governed by a board consisting of equal numbers of representatives of Copyright Owners and

Performers. 37 C.F.R. § 262.4(b)(2)–(3). Because SoundExchange has been separately incorporated and has no plans for dissolution or changing its board structure, I believe Section 262.4(b)(2)–(3) should be deleted from the current regulations. These provisions were an issue at the time the rates and terms for 2003 and 2004 were negotiated and are no longer applicable.

### CONCLUSION

SoundExchange has developed an effective and efficient mechanism for accomplishing the enormous task of collecting and distributing royalties for the hundreds of millions of sound recordings performed annually under Sections 112(e) and 114 of the Copyright Act. To maximize that distribution of royalties, SoundExchange should remain the sole collection and distribution agent. Consistent with the Copyright Act, it should be made clear that where a copyright owner has satisfied the elements of a claim for copyright infringement, the regulatory provision concerning payment of late fees does not preclude the claim. And information about payments under the public licenses conferred by Sections 112(e) and 114(d)(2) should be available publicly. The existing regulations should also be amended to account for the additional issues that I have described above.

I declare under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge.

  
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Barrie L. Kessler

Date: 10.28.05



soundexchange

## **Bio**

### **Chief Operating Officer Barrie Kessler**

Barrie Kessler has been SoundExchange's COO since July of 2001. As COO, she manages the infrastructure and personnel of the organization and implements various strategies to maximize the overall collection and distribution of royalties to SoundExchange's labels and artists.

Ms. Kessler brought over 15 years of database design and integration to SoundExchange, having served as principal consultant for numerous national and international corporations, including many within the U.S. sound recording industry. As the chief operating officer and information specialist for SoundExchange, she spearheaded the design and implementation of the Royalty Distribution System. Ms. Kessler is also charged with quality assurance of performance log administration. She provides technical expertise regarding reporting requirements both internally and before the Copyright Office. The evaluation of emerging and existing technology solutions for webcast performance tracking and assisting licensees with reporting compliance with the statutory license granted by the Digital Performance Right in Sound Recordings Act of 1995 (DPRA) and the Digital Millennium Copyright Act (DMCA) are conducted under Ms. Kessler's leadership.

Prior to SoundExchange, she served as Principal of Rock Creek Systems, an information technology consulting firm, where Ms. Kessler oversaw systems and database design, knowledge management, programming and data analyses for clients. Notable projects include the development of a broadcast monitoring data collection and reporting system for collecting rights societies, record companies, artists and governments in Brazil and Argentina and implementing the technology for establishing a database for a centralized musical recordings warehouse. As part of her consulting for RIAA programs, Ms. Kessler developed the certification system for Gold, Platinum and Multi-platinum record sales and created the royalty distribution system for the Alliance of Artists and Recording Companies (AARC).

Ms. Kessler's previous work included serving as Director of Systems for RSA, Inc. in Washington, D.C. where she directed project teams that provided

analytical and application design services to corporate clients. In that capacity, she created EIS systems for automating workflow and billing information for a major photojournalism corporation. She was also responsible for all aspects of the company's network administration.

Ms. Kessler also has extensive experience abroad having served two years as a database consultant for Price Waterhouse and DOS Computer Center in Madrid, Spain.

Ms. Kessler holds a Bachelor of Science degree in accounting and economics from Lehigh University.



## Exhibits Sponsored by Barrie L. Kessler

211 DP	Flow-chart illustrating SoundExchange's royalty collection and distribution procedures
212 DP	Sample SoundExchange Statement of Account
213 DP	Sample SoundExchange Notice of Election
214 DP	Sample SoundExchange Report of Use
252 DP	Sample SoundExchange Copyright Owner Statement reflecting performances associated with royalty payment
253 DP	Sample SoundExchange Artist Statement reflecting performances associated with royalty payment
259 DP	Sample Statement of account filed by satellite carrier Primetime 24 Joint Venture (Copyright Office Form SC)
260 DP	Sample statement of account filed by satellite carrier DirecTV, Inc. (Copyright Office Form SC)
261 DP	Sample statement of account filed by satellite carrier DirecTV Latin America (Copyright Office Form SC)
262 DP	Sample statement of account filed by cable television system Galaxy Cable Inc. (Copyright Office Form SA1-2)
263 DP	Sample statement of account filed by cable television system ComCast of Virginia (Copyright Office Form SA1-2)
264 DP	Sample statement of account filed by cable television system Southwest Cablevision (Copyright Office Form SA1-2)
265 DP	Agreement relating to distribution of satellite royalty fees by the Copyright Office
407 DP	Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings; Final Rule, 67 Fed. Reg. 45,239 (July 8, 2002) ("Webcaster I Librarian's Decision")
411 DP	Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings; Final Rule and order, 63 Fed. Reg. 25,394, 25,412 (May 8, 1998) ("PES I Librarian's Decision")
414 DP	Reply Comments of the Recording Industry Association of America, Inc., in Docket No. RM 2002-1A (Apr. 26, 2002)
415 DP	Comments of the Recording Industry Association of America, Inc., in Docket No. RM 2002-1A (Apr. 5, 2002)
416 DP	Comments of SoundExchange in Docket No. RM 2002-1H (May 27, 2005)

417 DP	Comments of SoundExchange, Inc., in RM 2005-2 in response to CRB request for Supplemental Comments (Aug. 26, 2005)
418 DP	Reply Comments of SoundExchange, Inc. in RM 2005-2 in response to CRB request for Supplemental Comments (Sept. 16, 2005)