

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Notice and Recordkeeping for Use of Sound
Recordings Under Statutory License

Docket No. RM 2011-5

COMMENTS OF SOUNDEXCHANGE, INC.

SoundExchange, Inc. (“SoundExchange”) is pleased to submit these Comments in response to the Judges’ Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding.

As SoundExchange explained in its Petition, it holds substantial royalties paid by statutory licensees under Sections 112(e) and 114 for the period from April 1, 2004 to December 31, 2009 that are not distributable because the licensees have failed to provide required reports of use. SoundExchange has worked diligently to try to obtain the missing reports of use so that these royalties could be paid to copyright owners and performers.

Since SoundExchange filed its Petition requesting this proceeding, SoundExchange has been able to secure from certain large webcasters historical reports that it had been seeking for a long time. As a result, the balance of pre-2010 royalties that SoundExchange is now holding due to failure of reporting stands at approximately \$19.4 million, or about 3% of the royalties that SoundExchange has collected for the April 1, 2004 to December 31, 2009 period. Unfortunately, SoundExchange is still missing reports from over a thousand different licensees. Because the potential returns from further pursuit of additional reports are diminishing rapidly, SoundExchange believes that it is very near the point where further delay and further investment

of resources in trying to locate missing data would be less reasonable than adoption and implementation of SoundExchange's proposal incorporated in the NPRM. SoundExchange therefore urges the Judges to adopt the proposed rule set forth in the NPRM.

In the remainder of these Comments, SoundExchange provides its response to the questions posed by the Judges in the NPRM.

- 1. Has SoundExchange exhausted all reasonable means to ensure that all undistributed royalties for the period from April 1, 2004, through December 31, 2009, have been distributed to the party that earned those royalties? If not, what other means could SoundExchange use to facilitate further distributions without resorting to proxy reports of use?**

As described in the Petition, SoundExchange has long employed both outreach and enforcement efforts to get licensees to provide the reporting data they are required to provide under the Judges' regulations. Those efforts have substantially reduced the balance of royalties being held, but also made clear that successfully obtaining historical reports requires a laborious and lengthy process of pursuing and engaging with individual licensees, and that many of the missing reports of use will never be obtained. With its recent receipt of long-awaited reports covering a substantial amount of usage, SoundExchange has reached a point of sharply diminishing returns in its efforts to secure reports of use for the period from April 1, 2004, through December 31, 2009. Although it is difficult to predict the cost in time and money of continuing to pursue missing reports of use from all the licensees who have failed to report, SoundExchange believes it is no longer reasonable to require it to continue holding onto these royalties in the hope that the services will eventually comply with their obligations.

The reasonableness of further efforts to pursue missing reports of use must be judged by balancing their benefits and costs. The potential benefit of further pursuit of missing reports of use is that – if they could be obtained – they might permit a more accurate distribution. But there

is a substantial question of how much more data could be obtained. SoundExchange has received reports of use corresponding to approximately 97% of the royalties it has received for the relevant period. While it is possible that reports of use for some of the other 3% of royalties could be produced, SoundExchange knows that it will never obtain reports of use for all of those royalties, because some of the relevant services are now out of business or have explicitly confirmed that they either cannot or will not generate reports of use for the earlier periods. As the relevant period continues to recede into the past and larger users have confirmed that they have provided all the data they have, it seems less and less likely that a material amount of useful data could be obtained from smaller services.

In addition, although inferior, the use of a proxy in these circumstances probably would not lead to a substantially less accurate distribution than the reporting that the pertinent regulations required. For most of the time in question, the applicable regulations permitted most services to report on the basis of a sample consisting of two weeks of play data per quarter, meaning that services that complied with their obligations under the regulations would still only have reported approximately 15% of their actual usage on their reports of use (assuming even usage across the period). *See* 37 C.F.R. Part 370. These sample reports of use were, in effect, “proxies” for the periods that were not reported – meaning that even fully-compliant reporting would not have actually covered the entire range of performances over the relevant period.

The potential benefits of further efforts to pursue missing reports of use must be balanced against their costs. The missing reports of use are spread among over a thousand different licensees. SoundExchange has engaged with many of them, but working intensively with each of them to assess and obtain any data that might be accessible would require a huge investment of SoundExchange staff’s time, which diverts them from processing of current payments and

reports of use and costs money, resulting in lower distributions to copyright owners and performers. *See* 17 U.S.C. § 114(g)(3)(A). In addition, requiring SoundExchange to continue pursuing reporting data will also take time, delaying distribution of these royalties even further, whether or not the data is ultimately ever obtained.

Balancing these potential benefits and costs, it is SoundExchange's clear sense that by the time this proceeding is concluded and SoundExchange could be ready to make a proxy distribution if authorized, it will have reached a point where further efforts to close the historical reporting gap will not be warranted. Accordingly, SoundExchange views the present circumstances as very much like the case of pre-2004 webcasting royalties, for which the Copyright Office approved use of a proxy distribution methodology, as described in the Petition. As in 2004, "[t]he likelihood of obtaining any useful and meaningful data" from non-reporting services will be "small." *See* Notice of Proposed Rulemaking, 69 Fed. Reg. 42,007, 42,008 (July 13, 2004). Even if some incremental data might be available, "the cost and effort that would be required of SoundExchange to process such inconsistent data would be disproportionate to the amount of useful data that would result." *Id.* Because "there simply is no way to fully and accurately reflect actual performances for the historical period," *id.*, SoundExchange views its proposal here as "the best solution for a bad situation." Notice and Recordkeeping for Use of Sound Recordings Under Statutory License, 69 Fed. Reg. 58,261 (Sept. 30, 2004). Just as it was not reasonable to pursue some potentially available data then, only a very limited further expenditure of the resources of copyright owners and performers can be justified now.. Fortunately, unlike in 2004, when it was necessary to use a proxy to distribute 100% of webcasting royalties, SoundExchange now proposes to use a proxy for distribution of only a small portion of the royalties that it has collected.

2. Assuming that SoundExchange has exhausted all reasonable means of distributing royalties to the parties who earned them, is the proposed use of proxy reports a fair and appropriate means of distributing remaining royalties for this period? If not, what would be a better alternative?

SoundExchange believes that the proposed rule set forth in the NPRM provides a fair and appropriate means of distributing the remaining royalties for the relevant period. The proposed proxy distribution would apply to only about 3% of royalties over the relevant period, and perhaps a little less if some additional services come through with missing reports in the interval before this proceeding is concluded and SoundExchange could be ready to make a proxy distribution. Distributing that 3% in proportion to assignable royalties for the same type of service and year, based on the reports of use that SoundExchange has actually received, would be based on real usage data to a large extent, and SoundExchange has not devised any alternative that would be demonstrably more fair.

In developing a solution to the difficult problem of non-reporting by licensees, SoundExchange was intensely concerned about treating the copyright owners and performers it represents fairly. For that reason, SoundExchange engaged Nathan Associates Inc. (“Nathan”), an economic consulting firm with significant experience in royalty distribution issues affecting copyright collectives, to advise SoundExchange concerning the development of an equitable proposal for addressing royalties that are not distributable due to missing reports of use.

As part of its work, Nathan evaluated distribution patterns across different service types, years, levels of music usage by services, and artist/copyright owner payment levels. Nathan specifically considered the fairness of application of the proposed proxy to the large and diverse set of webcasters. Because a small number of large webcasters make so many more performances, and pay so much more in royalties, than others, the proxy allocation will be heavily influenced by reported usage by higher-paying webcasters. Anticipating possible

questions as to whether usage by higher-paying webcasters is representative of usage by lower-paying webcasters, Nathan examined usage patterns by webcasters with varying levels of music usage. Nathan found that, in any year, the distribution of royalties from the highest-paying webcasters is similar to the aggregate distribution of royalties for all other webcasters reporting usage, alleviating concerns about potential bias toward usage reported by higher-paying services. Nathan therefore found that it would be fair and equitable to allocate royalties for which SoundExchange has no reports of use in proportion to assignable royalties for the same type of service and year. If any alternative proposals are suggested by other commenters, they should not be given serious consideration unless similar analysis shows that they would be clearly fairer.

3. **SoundExchange proposes using proxy reports of use based on available data for services of the same type, for the same year. Where no such proxy reports are available for the same type of service for the same year, is a default proxy based on an aggregate of the reports of other services covered by the license a fair and appropriate means of distributing royalties for this period. If not, what would be a better alternative?**

The circumstance posited in this question does not exist. In the aggregate, SoundExchange has received reports of use corresponding to about 97% of the royalties it has received for the relevant period. While the extent of the reporting SoundExchange has received varies from type of service to type of service and from year to year, SoundExchange generally has reports of use corresponding to a high proportion of the royalties it has received for each type of service and year. There is no year for which SoundExchange has received no reports of use for a particular type of service.

4. **Is the disaggregation by type of service proposed in § 370.4(f) (i.e., nonsubscription transmission service, preexisting satellite digital audio radio service, new subscription service, or business establishment service) sufficient to determine a reasonable proxy for generating corresponding reports of use for similar types of non-reporting services? Is further disaggregation of some service types, as currently referenced in 37 CFR Part 380 (e.g., disaggregation of nonsubscription transmission services into commercial webcasters, noncommercial webcasters, broadcasters, or noncommercial educational webcasters) desirable to determine a**

better proxy for generating corresponding reports of use for such non-reporting services? Would this type of further disaggregation be practicable? Would the benefits yielded by such further disaggregation, if any, justify the incremental costs of doing so?

SoundExchange believes that the methodology proposed in the NPRM provides a reasonable proxy, and that further disaggregation would be difficult and not lead to clearly better results.

As an initial matter, the issue addressed by this question relates uniquely to webcasting (services paying royalties under 37 C.F.R. Part 380). There are only a handful of services of each of the other types – preexisting subscription services (37 C.F.R. Part 382 Subpart A), preexisting satellite digital audio radio services (37 C.F.R. Part 382 Subpart B), new subscription services providing music for television services (37 C.F.R. Part 383), and business establishment services (37 C.F.R. Part 384). There is no evident basis for subdividing the non-webcasting service types, and because so few services are involved, any effort to do so risks creating the types of problems suggested by the Judges' question number 3.

As to webcasters, it is easy to imagine potential subdivisions, but implementing many of them would be difficult if not impossible, and there is no evidence that they would lead to fairer results. The available data from payments and statements of account – the only information SoundExchange has received from the non-reporting services – would only permit authoritative subdivision into commercial and noncommercial categories. With significant effort, it might be possible to distinguish payments and usage by commercial broadcasters from those of other commercial webcasters, and payments and usage by educational webcasters from those of other noncommercial webcasters, to a reasonable degree of accuracy. But it is not clear that such a subdivision would result in a fairer distribution, because each of those subdivisions is itself large and diverse, encompassing widely-varying services using different genres of music at varying

levels of intensity. As a result, it is not clear that usage by any individual service would be more like usage by other members of its subdivision than by webcasters as a whole.

In addition, it is important to recognize that the possibility of subdivision of the webcaster pool would affect only (at most) relative allocation of royalties, not entitlement to royalties. The approach proposed in the NPRM will result in allocation of webcasting royalties to everyone whose work was reported as used by a webcaster. Any possible subdivision of the webcaster category would not change *who* receives an allocation of royalties, because that is a function of the reported webcast performances, and the overall webcaster distribution would still be based on the same reported usage. At most, subdivision would result in a change to the relative allocation between the recipients, and even then, it would only have an effect to the extent that there were material differences between any subdivision and the larger webcaster population as to usage patterns and the value attributed to reported usage based on the proxy. Figuring out the precise effect of any proposed subdivision would be extremely difficult and, ultimately, not cost effective. Nathan's analysis suggests that any change in allocation would likely be small, because the proposed proxy would result in a percentage distribution of royalties to both higher- and lower-paid artists and copyright owners that is generally consistent with reported usage by services with diverse levels of music usage.

Moreover, the total royalties paid by noncommercial webcasters are small, because these services overwhelmingly pay only the minimum fee of \$500. Thus, the financial impact of separating out that subdivision on the overall pattern of distribution would necessarily be slight.

Finally, although the use of a proxy is necessarily imperfect, the proxy distribution methodology proposed in the NPRM is dramatically better than the one used for pre-2004 webcasting royalties. That methodology involved distributing payments by what was even then

a large number of webcasters using data provided by a handful of services of a completely different type – the preexisting subscription services. 69 Fed. Reg. at 42,008. SoundExchange’s proposal for this proxy is much more tailored than what the Copyright Office approved then.

SoundExchange has been unable to identify any reasonable approach that would achieve a clearly fairer allocation of webcaster royalties than the proxy proposed in the NPRM (which is a dramatic improvement over the pre-2004 proxy). And a more complicated approach would require effort and give rise to delay, likely to little positive effect. As a result, SoundExchange should not be required to expend the resources of copyright owners and performers in pursuit of an allocation methodology based on subdivision of the webcaster category unless another commenter can provide strong evidence that an alternative would be workable and result in a substantially more accurate distribution.

5. Does the proposed regulatory language in §§ 370.3(i) and 370.4(f) (i.e., “* * * service has not provided a report of use required under this section * * *)” clearly encompass both the failure of a service to provide reports of use as well as instances where the service files an unusable report of use?

The lion’s share of the problem SoundExchange hopes to remedy by its proposed proxy distribution arises because services have, for at least certain reporting periods, failed to provide a report of use at all. Nonetheless, SoundExchange believes that the proposed rule is sufficiently clear that it would treat in the same manner any instance where a service had provided a report of use that is so defective as to be unusable.

When SoundExchange receives a report of use, it makes a good faith effort to try to use it for distribution of the service’s royalties, even if the service failed to comply with the very specific requirements of 37 C.F.R. Part 370 that are a condition of the statutory license. *See* 17 U.S.C. § 114(f)(4)(B)(i). However, services sometimes provide a report that is so unpopulated or so full of bad data that it is effectively unusable. In such a case, the service has come nowhere

near complying with the letter or the spirit of the Judges' notice and recordkeeping regulations, and so effectively "has not provided a report of use required under this section."

While SoundExchange does not believe that any clarification of the rule is necessary to adequately address situations where it has received a badly defective report of use, SoundExchange is open to any clarification of this point that the Judges may find helpful.

CONCLUSION

The proxy allocation methodology proposed in the NPRM reflects "the best solution for a bad situation." *See* Notice and Recordkeeping for Use of Sound Recordings Under Statutory License, 69 Fed. Reg. 58,261 (Sept. 30, 2004). Copyright owners and performers should not have to expend further resources or wait longer to receive royalties they have collectively earned, in the hope that it might be possible to achieve a slightly more accurate distribution of the last 3% of statutory royalties for which SoundExchange is missing reports of use. Accordingly, SoundExchange urges the Judges to adopt the proposed rule.

May 19, 2011

Respectfully submitted,



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