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

In re **DETERMINATION OF ROYALTY RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (Phonorecords III)**	Docket No. 16-CRB-0003-PR (2018-2022)

COMMENTS AND OBJECTION OF SONY MUSIC ENTERTAINMENT CONCERNING PROPOSED SETTLEMENT

Sony Music Entertainment ("SME") provides these comments in response to the Copyright Royalty Judges' publication in the *Federal Register* of the proposed settlement ("Settlement") among various copyright owner participants in this proceeding, Universal Music Group ("UMG") and Warner Music Group ("WMG"). *See* 81 Fed. Reg. 48,371 (July 25, 2016).

SME supports the Settlement insofar as it extends the royalty rates specified in 37 C.F.R. § 385.3. Extending those rates is a "reasonable basis for setting statutory . . . rates." 17 U.S.C. § 801(b)(7)(A)(ii). SME urges the Judges promptly to issue an order adopting the Settlement as to all licensees under Section 115 insofar as it extends the royalty rates specified in 37 C.F.R. § 385.3. Entry of such an order at an early date would streamline this proceeding by eliminating the need for the participants to present, and the Judges to consider, evidence concerning such rates.

However, SME objects to the Settlement insofar as it extends the late fee provision specified in 37 C.F.R. § 385.4. While SME is not opposed in principle to a term requiring payment of a late fee when a licensee is merely late in making a payable payment, the current late fee provision does not fully contemplate circumstances in which payments can and should be

delayed. Thus, SME anticipates seeking tailoring of this provision in the proceeding. Because the settling participants apparently have exempted themselves from this provision by a side agreement, the Settlement does not provide a reasonable basis for extending the current version of 37 C.F.R. § 385.4 to licensees other than UMG and WMG.

Finally, the Judges proposed amending 37 C.F.R. § 385.1(a) to specify that the rates to be set in this proceeding will be applicable "during the period January 1, 2018, through December 31, 2022." 81 Fed. Reg. at 48,372. While those would be proper effective dates for such rates, the actual effective dates prescribed by statute may be different, and the initial date *will* be different if the Judges follow the case schedule they have ordered for this proceeding. *See* 17 U.S.C. § 803(d)(2)(B). While it is a technical point, SME objects to the proposed amendment of 37 C.F.R. § 385.1(a) to the extent it is inconsistent with 17 U.S.C. § 803(d)(2)(B).

I. The Judges Should Extend the Royalty Rates in 37 C.F.R. § 385.3

SME supports the Settlement insofar as it extends the royalty rates specified in 37 C.F.R. § 385.3. Such rates are clearly reasonable, because by virtue of the Settlement and SME's support thereof, these rates have been accepted by participants in this proceeding that represent the vast majority of music publishers and songwriters, as well as by all the record company participants in this proceeding, which collectively produce or distribute approximately 85% of the sound recording products distributed in the U.S. The Judges previously found these rates to be "reasonable" when they set them in *Phonorecords I*. 74 Fed. Reg. 4510, 4526 (Jan. 26, 2009).[1]

If it should be necessary to litigate over these rates in this proceeding, the record would show what it did in *Phonorecords I* – that even in circumstances in which the compulsory license

[1] The Judges also extended these rates as the result of a settlement in *Phonorecords II*. 78 Fed. Reg. 67,938 (Nov. 13, 2013).

provided by Section 115 is unavailable to copyright users, mechanical licensing for the product configurations for which rates are specified in 37 C.F.R. § 385.3 occurs in the marketplace at royalty rates that are at or somewhat below the statutory rates, and never above the statutory rates. *See* 74 Fed. Reg. at 4519-21. Given those circumstances, the statutory rates remain reasonable.

That conclusion is not negated by the multiple oppositions to the Settlement filed by Mr. George Johnson. The thrust of Mr. Johnson's argument is that the statutory mechanical royalty for physical products and downloads should be increased to at least 52 cents, if not four or five dollars, due to the effects of inflation since 1909 and his perceptions of the historical value of songs. *See* George Johnson's (Geo) Opposition to Parties Motion to Adopt Settlement, at 6-10 (June 27, 2016). However, the exhibits to Mr. Johnson's oppositions belie his conclusions. Mr. Johnson's own Exhibits B through D show clearly that the price of sound recording products has not increased at anything like the rate of general monetary inflation, and in fact has decreased in both absolute and inflation-adjusted terms. At Mr. Johnson's minimum rate of 52 cents, the total mechanical royalty on a 14-track album would be $7.28. Yet Mr. Johnson's Exhibit C shows that the average price of an album in 2014 was $11.97 (which appears to be a retail price). Thus, based only on Mr. Johnson's own submission, Mr. Johnson would have the mechanical royalty constitute some 61% of the retail price of an album, with various other royalty recipients (including the performing artist), the record company, the distributor and the retailer having to share the remaining 39%. At $4.00, the total mechanical royalty of $56 for a 14-track album would be almost five times what Mr. Johnson's Exhibit C shows as the average price of an album. These are obviously absurd results, which have no more justification than Mr. Johnson's

rate request in the *Webcasting IV* proceeding. *See* 81 Fed. Reg. 26,316, 26,355 (May 2, 2016) (finding "no evidence, other than his personal view, that such rates are reasonable").

For these reasons, SME urges the Judges to extend the royalty rates specified in 37 C.F.R. § 385.3 for the coming rate period as to all licensees under Section 115. Furthermore, SME urges the Judges to do so at an early date to streamline this proceeding. Settlements play an important role in the statutory license ratesetting process. *See, e.g.*, H. Rep. No. 108-408, at 30 (Jan. 30, 2004) ("the Committee intends that the bill as reported will facilitate and encourage settlement agreements for determining royalty rates"). Toward that end, Section 801(b)(7)(A) of the Copyright Act creates a presumption that settlements among participants in a rate proceeding will be adopted by the Judges as the relevant statutory royalty rate. Assuming a settlement is consistent with law:[2]

> The Judges "may decline to adopt the agreement as a basis for statutory terms and rates for participants that are not parties to the agreement," only "if any participant [to the proceeding] objects to the agreement and the [Judges] conclude, based on the record before them if one exists, that the agreement does not provide a reasonable basis for setting statutory terms or rates."

78 Fed. Reg. 67,938, 67,939 (Nov. 13, 2013) (quoting 17 U.S.C. § 801(b)(7)(A)(ii); alterations in original).[3] Importantly, the Judges are empowered to adopt a settlement "at any time during the proceeding." 17 U.S.C. § 801(b)(7)(A). There is no reason to delay adoption of a settlement that is broadly supported by the affected industries. The Judges should streamline this proceeding by

[2] Of course the Judges "are not compelled to adopt a privately negotiated agreement to the extent that it includes provisions that are inconsistent with the statutory license." *Review of Copyright Royalty Judges Determination*, 74 Fed. Reg. 4537, 4540 (Jan. 26, 2009). However, extending the rates specified in 37 C.F.R. § 385.3 raises no apparent issues in that regard.

[3] *See also* 74 Fed. Reg. at 4514 ("Only if an objection is received by one or more of the parties are [the Judges] given any discretion over the settlement, and then [the Judges] are limited to rejecting it if [they] determine that the settlement 'does not provide a reasonable basis for setting statutory rates and terms.'" (quoting 17 U.S.C. § 801(b)(7)(A)(ii))).

issuing an order at an early date adopting the Settlement insofar as it extends the royalty rates specified in 37 C.F.R. § 385.3 for the coming rate period.

II. The Judges Should Not Extend the Late Fee in 37 C.F.R. § 385.4

While SME supports the rates in the Settlement, SME objects to the Settlement as to its terms, which extend the late fee provision of 37 C.F.R. § 385.4 for the coming rate period. Importantly, the Settlement appears on its face to apply the late fee provision to UMG and WMG. However, the settling participants have apparently agreed among themselves to provide UMG and WMG relief from that provision by a separate private contract. *See* Motion to Adopt Settlement, at 3 (June 15, 2016) ("Concurrent with the Settlement, UMG, WMG and NMPA have separately entered into a memorandum of understanding providing for the continuation of certain licensing processes and late fee waivers.").[4] It is plainly *not* reasonable to extend to objecting third parties, including SME, aspects of a settlement that do not actually apply to the parties to the settlement themselves.

SME is not opposed in principle to a term requiring payment of a late fee when a licensee is merely late in making a payable payment. SME always tries to make its mechanical royalty payments on a timely basis whenever practicable. Thus, SME does not expect to propose fundamental alterations to 37 C.F.R. § 385.4 in this proceeding. However, payments under Section 115 and its implementing regulations are significantly more complicated than under Section 114 and its implementing regulations, which provided the model for the late fee provision of 37 C.F.R. § 385.4. *See* 74 Fed. Reg. 4527 (referring to "adoption of the same term for late payments in the *Webcaster II* and *SDARS* determinations").

[4] Further information concerning relief from 37 C.F.R. § 385.4 that has been provided by contract was contained in a statement provided to the Judges in connection with the settlement of *Phonorecords II*. A copy of that statement is attached as Exhibit A.

Unlike Section 114, Section 115 licenses generally must be obtained through an interaction between the licensee and the copyright owner or its agent, and the royalty must be paid directly to one or more copyright owners of the work or their agents. *See, e.g.*, 37 C.F.R. §§ 201.18(a), 210.16(g)(1). Frequently, works are co-owned, and the specific ownership interests are not agreed upon among the relevant authors and copyright owners until well into the commercial life of a song. Section 115 and its implementing regulations also contain complicated provisions concerning when royalty payments must be paid. Current 37 C.F.R. § 385.4 does not fully comprehend various complications relevant to payments under Section 115. For example:

- Under 17 U.S.C. 115(c)(1), a copyright owner is not entitled to receive mechanical royalties unless and until it is identified in the Copyright Office's registration records.

- Under 37 C.F.R. § 210.16(g)(1), a licensee is, in certain circumstances, not required to make royalty payments until it receives certain information from an agent of the copyright owner.

- 37 C.F.R. § 210.16(g)(4) recognizes that payments sometimes may be undeliverable, due to no fault of the licensee.

- Under 37 C.F.R. § 210.16(g)(6), payments that are so low that it is not practicable to account for and transmit them on a current basis may be deferred for a time.

- 37 C.F.R. § 210.16(g)(7) recognizes that withholding of payments sometimes may be required by otherwise applicable law, such as tax law.

- In the case of disputes, such as disputes among music publishers and songwriters as to who is entitled to receive mechanical royalty payments, it does not make sense, and it is not industry practice, for licensees to send mechanical royalty payments to someone who ultimately may not be entitled to receive them.

As explained in the Declaration of Andrea Finkelstein accompanying SME's opposition to the motion to exclude SME from this proceeding, after the Judges initially adopted 37 C.F.R. § 385.4, SME promptly heard from music publishers that they were, among other things, entitled

to receive late fees covering periods of time when SME could not possibly pay a mechanical royalty, because the relevant songwriters and publishers had not yet agreed concerning authorship of the relevant song and their respective ownership shares, and a royalty would not be payable under Section 115 and its implementing regulations. Finkelstein Decl. ¶ 24. Accordingly, in this proceeding, SME expects to request certain tailoring of 37 C.F.R. § 385.4 to reflect applicable statutory and regulatory payment requirements and foreclose inappropriate claims to late fees in circumstances that are beyond the control of the licensee.

For these reasons, the Judges should not adopt the Settlement insofar as it seeks to extend 37 C.F.R. § 385.4 to licensees other than UMG and WMG.

III. The Judges Should Recognize that the Effective Dates of Statutory Mechanical Royalty Rates Depend upon the Timing of their Determinations

While it is perhaps a technical point, SME feels constrained to object to the Judges' proposed amendment of 37 C.F.R. § 385.1(a). That amendment would make the rates to be adopted as a result of the Settlement effective "during the period January 1, 2018, through December 31, 2022." However, pursuant to 17 U.S.C. § 803(d)(2)(B), those effective dates would be proper only if the Judges' determinations in this proceeding *and the next one* are published in the *Federal Register* during the month of November immediately prior to those dates.

The statutory provisions governing Section 115 royalty rate periods, and the timing of Section 115 ratesetting proceedings, are different from the provisions governing Section 114. While Section 114 rates are set for five-year periods that begin on January 1 and end on December 31, *see, e.g.*, 17 U.S.C. § 114(f)(1), Section 115 rates remain in effect until replaced, *see* 17 U.S.C. § 115(c)(3)(C). Because Section 115 rates "do not expire on a specified date, successor rates and terms shall take effect on the first day of the second month that begins after

the publication of the determination of the Copyright Royalty Judges in the Federal Register." 17 U.S.C. § 803(d)(2)(B). This cannot be "earlier than January 1 of the second year following the year in which the petition requesting the proceeding is filed." 17 U.S.C. § 115(c)(3)(C). However, it can be later. Consistent with that principle, the Judges have more latitude in determining when to issue a Section 115 determination than a Section 114 determination. *See* 17 U.S.C. § 803(c)(1) (requiring that a determination issue "15 days before the expiration of the then current statutory rates and terms," but only "in the case of a proceeding to determine successors to rates or terms that expire on a specified date"). The Judges' previous Section 115 determinations have been timed such that the new rates were effective more than two years after commencement of the proceeding. 78 Fed. Reg. at 67,939 (in proceeding beginning in 2011, rates effective January 1, 2014); 74 Fed. Reg. at 4510 (in proceeding beginning in 2006, rates effective March 1, 2009).

While January 1, 2018 would be a proper effective date for rates to be determined in this proceeding, it will actually be the effective date only if the Judges publish their determination in the *Federal Register* in November of 2017 (earlier than the date presently provided in the case schedule for issuance of the initial determination). *See* 17 U.S.C. § 803(d)(2)(B).[5] Similarly, while December 31, 2022, would be a proper end date for rates to be determined in this proceeding, it will actually be the end date only if the Judges publish their determination in the *next* phonorecords proceeding in the *Federal Register* in November of 2022. *See id.* The Judges should not adopt regulatory language suggesting that the rates and terms to be adopted in this proceeding become effective, or expire, before they do by statute.

[5] January 1 is the first day of the second month that begins after November.

IV. Conclusion

For these reasons, SME urges the Judges promptly to issue an order adopting the Settlement as to all licensees insofar as it extends the royalty rates specified in 37 C.F.R. § 385.3. However, SME objects to adoption of the Settlement as to SME insofar as it extends the late fee provision specified in 37 C.F.R. § 385.4. SME also urges the Judges either to leave 37 C.F.R. § 385.1(a) unmodified, as contemplated by the original Settlement among the participants, or to adopt a temporal provision consistent with 17 U.S.C. § 803(d)(2)(B).

Dated: August 24, 2016

Respectfully submitted,

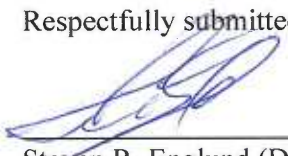

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Exhibit A

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

In the Matter of:

Adjustment or Determination of Compulsory License Rates for Making and Distributing Phonorecords

Docket No. 2011-3 CRB Phonorecords II

SUPPLEMENTAL STATEMENT OF RIAA AND NMPA

The Recording Industry Association of America, Inc. ("RIAA") and the National Music Publishers' Association, Inc. ("NMPA") respectfully submit this Supplemental Statement in connection with the Motion to Adopt Settlement ("Motion") filed by them and other participants in this proceeding. This Supplemental Statement is submitted in connection with Section 385.4 of the proposed regulations appended to the Motion, to describe a Memorandum of Understanding entered into by RIAA, NMPA and The Harry Fox Agency, Inc. ("HFA") in connection with the Judges' adoption of current Section 385.4 and a similar Memorandum of Understanding entered into by those parties and others as a package with the settlement addressed by the Motion (the "2013-2017 Settlement").

In the last Section 115 rate-setting proceeding, the Copyright Royalty Judges adopted for the first time a late fee applicable under Section 115. As a result, RIAA and NMPA began discussions to improve industry licensing processes and resolve certain disputed issues relating to late payments. These discussions led to a Memorandum of Understanding (the "MOU") between RIAA, NMPA and HFA dated November 10, 2009. The MOU created a comprehensive program for the major record companies and participating music publishers to work together to improve mechanical licensing practices and encourage prompt dispute resolution, and for publishers to waive certain late fees during the current statutory mechanical

royalty period for major record companies who complied with the licensing and clearance rules and practices set forth in the MOU. Over 97% of the music publishing industry on a market share basis ultimately opted to participate in the MOU. In connection with the 2013-2017 Settlement, the parties have simultaneously agreed to the continuation in the proposed regulations of the late fee term of Section 385.4 and a new Memorandum of Understanding ("MOU 2") providing for the continuation for the next rate period of improved processes for the clearance and/or licensing of product and late fee waivers similar to those applicable under the original MOU.

The original MOU addressed three primary aspects of payments by record companies to music publishers, (i) the bulk distribution of pending and unmatched ("P&U") royalties, (ii) the implementation of processes for record companies and music publishers to work cooperatively on clearance and/or licensing of new releases, and in the absence of agreement concerning ownership and rates, a path to resolution of disputes and payment where possible, and (iii) waiver of the late fee in certain instances where record companies were in compliance with the practices set forth in the MOU.

The processes in the original MOU have worked well for the parties. The MOU2 will continue, and expand in some instances, the practices and processes set forth in the original MOU. The parties to the MOU and MOU 2 are pleased that they were able to agree concerning these matters in connection with the proposed 2013-2017 Settlement.

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