

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

In the Matter of:

Petition to Use a Proxy to Distribute Certain
Sound Recording Royalties

Docket No. RM 2011-5

**PETITION OF SOUNDEXCHANGE, INC. FOR A RULEMAKING
TO AUTHORIZE USE OF A PROXY TO DISTRIBUTE
CERTAIN PRE-2010 SOUND RECORDING ROYALTIES**

Pursuant to 5 U.S.C. § 553(e) and 17 U.S.C. §§ 112(e), 114 and 803(b)(6)(A), SoundExchange, Inc. (“SoundExchange”) hereby requests that the Copyright Royalty Judges commence a rulemaking proceeding to consider, and in due course adopt, a notice and recordkeeping regulation authorizing SoundExchange to use proxy reporting data to distribute to copyright owners and performers certain sound recording royalties for periods before 2010 that are otherwise undistributable due to licensees’ failure to provide reports of use.¹

As the Judges know well, SoundExchange is the sole collective that has been designated to collect and distribute sound recording royalties under the statutory licenses provided by Sections 112(e) and 114 of the Copyright Act. SoundExchange is governed by an 18-member Board of Directors that is made up of equal numbers of artist representatives and sound recording copyright owner representatives. SoundExchange’s core mission is to ensure the prompt, fair and efficient collection and distribution of sound recording royalties.

¹ As described further below, SoundExchange is *not* seeking *prospective* authority to use a proxy. The request is limited to the period from April 1, 2004 through December 31, 2009.

From the inception of the Section 112/114 statutory licenses through the present, SoundExchange has distributed hundreds of millions of dollars in royalties to artists and rights owners. However, SoundExchange has also received royalties that it *cannot* distribute because, for whatever reason, licensees have either failed to provide reports of use, or have provided reports of use that are so deficient as to be unusable.² SoundExchange has worked diligently to solve such problems, but for periods before 2010, believes that it has nearly exhausted what it is reasonable to do and therefore seeks this relief so that it can distribute otherwise undistributable royalties to artists and rights owners.

At present, SoundExchange holds approximately \$28 million in royalties paid by statutory licensees under Sections 112(e) and 114 for the period from April 1, 2004 to December 31, 2009 that should be paid to copyright owners and performers but are not distributable because the licensees have failed to provide reports of use as required by 37 C.F.R. Part 370 or predecessor notice and recordkeeping regulations. This pool of undistributable royalties represents about 4.5% of the royalties that SoundExchange has collected for that period.

SoundExchange has expended considerable effort to bring licensees into compliance with requirements for providing reports of use and to obtain available historical data. Unfortunately, while SoundExchange will continue to work toward obtaining missing historical reports of use, SoundExchange is rapidly approaching the point at which further efforts would either be futile or unreasonably costly in terms of both time and money, such that the only way the remaining pre-2010 royalties not associated with reports of use can reasonably be distributed to rights owners

² The remainder of this Petition uses the phrase “failure to provide reports of use” to refer to both instances in which services altogether failed to provide reports of use and instances in which services provided reports of use that were unusable.

and artists is by way of a proxy. There is precedent for such an action: Previously, when the failure of webcasters to maintain data concerning their usage of sound recordings prior to April 1, 2004 precluded distribution of their royalty payments to the proper payees, the Copyright Office authorized distribution of those royalties based on a “proxy” consisting of reports of use provided by preexisting subscription services. *See* Notice and Recordkeeping for Use of Sound Recordings Under Statutory License, 69 Fed. Reg. 58,261 (Sept. 30, 2004); *see also* 37 C.F.R. § 270.4. Because authority to adopt notice and recordkeeping regulations has since been transferred to the Judges, SoundExchange now requests that the Judges adopt a similar regulation authorizing SoundExchange retroactively to make a proxy-based distribution of statutory license royalties paid for periods before January 1, 2010 that are not distributable because the licensees have not provided reports of use.

As in the case of pre-2004 webcasting royalties, SoundExchange believes that it has reduced the pool of royalties that are undistributable due to missing reports of use to a point such that in the near future “[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 additional, incomplete data might be available at that point in time, “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.* Thus, “there simply is no way to fully and accurately reflect actual performances for the historical period.” *Id.* As a result, SoundExchange views its proposal here as “the best solution for a bad situation.” 69 Fed. Reg. at 58,261.

Proposed regulatory language granting SoundExchange authority to implement the proposal described herein is attached as Exhibit A. The remainder of this Petition provides

additional background concerning the present situation and additional information concerning SoundExchange's proxy distribution proposal.

I. THE JUDGES HAVE AUTHORITY TO ADOPT SOUNDEXCHANGE'S PROPOSED REGULATIONS

The Judges have authority to adopt SoundExchange's proxy distribution proposal. As discussed below, SoundExchange's proposal is structured in a manner comparable to the pre-2004 webcasting proxy provision, which was adopted by the Copyright Office as a notice and recordkeeping regulation. *See* 37 C.F.R. § 270.4(b). At that time, adoption of notice and recordkeeping regulations was the province of the Office. Its authority, including the ability to adopt notice and recordkeeping regulations along the lines proposed by SoundExchange, has since been transferred to the Judges. 17 U.S.C. §§ 112(e)(4), 114(f)(4)(A).

More generally, the Judges are responsible for administering the terms of royalty payments under Sections 112 and 114, 17 U.S.C. § 801(b)(1), and may issue regulations to carry out their functions, 17 U.S.C. § 803(b)(6)(A). In so doing, the Judges must comply with the Administrative Procedure Act, to the extent not inconsistent with the Copyright Act. 17 U.S.C. § 803(a)(1). The Administrative Procedure Act requires agencies to "give an interested person the right to petition for the issuance, amendment, or repeal of a rule." 5 U.S.C. § 553(e). Adopting a rule, pursuant to such a petition, to allow for the distribution of royalties to copyright owners and performers despite reporting failures by licensees is well within the Judges' general authority to issue regulations to carry out their functions.³

³ Correcting the cross reference errors identified in note 5 and Exhibit A is also permitted under 17 U.S.C. § 803(c)(4).

II. DESCRIPTION OF THE PROBLEM

For as long as the sound recording statutory licenses have existed, a persistent and widespread problem has been a lack of data concerning use of sound recordings by services. When the Copyright Office first implemented notice and recordkeeping requirements under Section 112 and 114 for webcasters, it found that for the period from October 28, 1998 to the effective date of the new regulations (April 1, 2004), “few, if any, records of prior use had been maintained to date and those that do exist would be of little or no use in forming the basis for distribution of royalties for the historic period.” 69 Fed. Reg. at 58,261. The Copyright Office solved this problem by adopting a regulation authorizing distribution of webcasting royalties for the relevant period based on a “proxy” consisting of reports of use provided by “preexisting subscription services.” *See Notice and Recordkeeping for Use of Sound Recordings Under Statutory License*, 69 Fed. Reg. at 58,261.

The Judges’ recent notice and recordkeeping proceeding (Docket No. RM 2008-7) clearly illustrates that noncompliance with notice and recordkeeping regulations by licensees remains widespread. For example, a survey reported in the record of that proceeding indicated that less than 12% of college stations that were then webcasting were submitting compliant reports of use.⁴ This, unfortunately, is common. SoundExchange has frequently received from diverse types of services royalty payments for which it never received the reports of use necessary to distribute those royalties to the proper payees. Some of those services are now out of business. And many larger services that now generally report their usage on a timely basis sometimes have

⁴ Comments of College Broadcasters, Inc., Docket No. RM 2008-7, at 4 (May 26, 2009).

gaps in their historical reporting that they have not been able to fill, and have explicitly confirmed that they either cannot or will not generate reports of use for the earlier periods.

Consistent with applicable regulations, SoundExchange distributes royalties “based upon the information provided under the reports of use requirements.”⁵ Thus, when SoundExchange receives royalty payments without accompanying reports of use, SoundExchange presently has no choice but to hold the royalties. Even if copyright owners were to sue for infringement based on noncompliance with the requirements of the statutory license, *see* 17 U.S.C. § 114(f)(4)(B), the current regulations do not authorize SoundExchange to distribute the royalties it has received other than on the basis of reports of use.

Importantly, SoundExchange has tried to solve the problem of missing reports of use through both outreach and enforcement efforts directed to noncompliant services. SoundExchange personnel contact licensees as a matter of routine to remind them of their reporting obligations under the statutory license and to request that they submit missing reports of use. SoundExchange also has held webinars for licensees to learn more about the reporting requirements, and sent staff to conferences to speak to service providers about their obligations. SoundExchange has informed licensees directly of instances in which the licensees’ submitted reports are deficient, and for several years, it has devoted considerable effort to working with services one-on-one to obtain available historical data. Through these efforts, and by way of example, from 2008 through 2010, SoundExchange obtained long-overdue reports of use related

⁵ 37 C.F.R. §§ 380.4(g)(1), 382.3(c)(1), 382.13(f)(1); *accord* 37 C.F.R. § 384.4(g). Since the renumbering of the notice and recordkeeping provisions in Docket No. RM 2008-7, certain of these royalty distribution provisions that point to Part 370 to identify the reports of use to be used by SoundExchange in distributing royalties no longer identify the corresponding report of use requirements. Technical corrections are suggested in Exhibit A.

to more than \$40 million in royalties. As a result, the effects of this reporting problem have been narrowed to less than \$28 million in undistributable royalties – representing approximately 4.5% of SoundExchange’s royalty receipts over the relevant period.

SoundExchange’s efforts over the last several years to address this problem have been prioritized in a manner consistent with prudent stewardship of the resources of artists and rights owners, and efforts to obtain missing reports of use are becoming less and less efficient. The remaining missing pre-2010 reports of use are spread diffusely among approximately 1,050 different licensees, some of which are no longer in business. At a point in the near future, obtaining a significant reduction in the overall amount of royalties associated with missing reports of use may be impossible, or will at least require an expenditure of time and money that, as in the case of the pre-2004 missing reports of use, would be “disproportionate to the amount of useful data that would result.” 69 Fed. Reg. at 42,008. Indeed, in many cases of licensees with low usage of sound recordings or only some missing reports, further attempts to track down reports of use might cost more in resources than the royalties associated with the missing reports, which clearly would be to the detriment of artists and rights owners.

In addition, SoundExchange has substantially mitigated the compliance problem going forward. Many licensees that have had gaps in their historical reporting are now providing reports of use on a regular basis, and SoundExchange is implementing programs to bring others into compliance. Moreover, approximately 450 webcasters with low levels of music usage have opted into agreements under the Webcaster Settlement Act that allow proxy distribution of their royalty payments. *See, e.g.*, Agreed Rates and Terms for Broadcasters § 5.1, 74 Fed. Reg. 9299, 9301 (Mar. 3, 2009); Agreed Rates and Terms for Noncommercial Educational Webcasters § 5.1.1, 74 Fed. Reg. 40,616, 40,618-19 (Aug. 12, 2009). A similar option is also now available

to certain services as part of the statutory webcasting terms adopted by the Judges in the *Webcaster III* proceeding. 76 Fed. Reg. 13,026, 13,052, 13,056 (Mar. 9, 2011) (§§ 380.13(g)(2), 380.23(g)(1)).

By the time the Judges are able to complete a rulemaking with respect to this petition, SoundExchange believes that it will no longer be in the interest of copyright owners or performers to continue to pursue mathematically perfect distribution of the remaining balance of its pre-2010 royalties that are undistributable due to missing reports of use. As in the case of pre-2004 webcasting royalties, SoundExchange believes that it soon will reach a point at which “[t]he likelihood of obtaining any useful and meaningful data is small.” 69 Fed. Reg. at 42,008. While SoundExchange only recommends proxy distribution in limited circumstances when other approaches do not seem practicable, the present situation is analogous to the case of pre-2004 webcasting royalties. Just as the Copyright Office adopted a proxy distribution model then, SoundExchange asks the Judges to adopt such a proposal now.

III. SOUNDEXCHANGE’S PROPOSED REGULATIONS

SoundExchange hereby requests that the Judges amend their notice and recordkeeping regulations as provided in Exhibit A to grant authority, similar to that previously provided for pre-2004 webcasting royalties, to make a proxy-based distribution of statutory license royalties for periods before January 1, 2010 that are not distributable because the licensees have not provided reports of use or the licensees have provided reports of use that are defective.

The proposed proxy is a simple approach to solving the reporting problem, with efficiency and cost-savings advantages comparable to those that the Copyright Office found with respect to the proxy distribution of the pre-2004 webcasting royalties. *See* 69 Fed. Reg. at

42,008. Importantly though, the proxy authority that SoundExchange is seeking is calculated to achieve a much more tailored distribution than the authority that was granted as to pre-2004 royalties. In the case of the pre-2004 webcasting royalties, the proxy that was used (with the Copyright Office's approval) was reports of use by a completely different type of service than webcasters, namely, preexisting subscription services. Specifically, SoundExchange took "royalties paid for a given period in the historic timeframe and then . . . 'allocate[d] those royalties according to the same percentages used for the allocation of royalties paid by the preexisting subscription services for the corresponding period.'" 69 Fed. Reg. at 42,008.

Here, SoundExchange proposes to do something similar, except that in each case it would use available data for services of the *same* license type, for the same year, which SoundExchange believes would result in a much more accurate distribution. Thus, SoundExchange proposes to distribute webcasting royalties for which it has no reports of use in proportion to assignable webcasting royalties from the same year, business establishment services royalties for which it has no reports of use in proportion to assignable business establishment services royalties from the same period year, and so forth. The proxy distribution also would be based on a greater number of available reports of use than the pre-2004 proxy distribution.

To help assess the fairness of such a proxy, SoundExchange engaged Nathan Associates Inc. ("Nathan"), an economic consulting firm with significant experience in royalty distribution issues affecting copyright collectives, to advise SoundExchange concerning this proposal.

Nathan analyzed the proposed proxy and determined that distributing royalties on the basis of this proposal would be fair and equitable. In particular, Nathan evaluated the effects of application of the proxy across different service types, years, levels of music usage by services, and artist/copyright owner payment levels. Within each category of service and year, Nathan

found that the proxy resulted in a percentage distribution of royalties to both higher- and lower-paid artists and copyright owners that was generally consistent with reported usage by services with diverse levels of music usage. Thus, Nathan's work indicates that SoundExchange's proposed proxy is appropriate, because use of recordings by services that did not provide reports of use was likely similar to use of sound recordings by services of the same types that did provide reports of use for the same periods.

Based on the foregoing, SoundExchange believes that distributing the pre-2010 royalties that are undistributable because of a lack of reports of use as described above would be a fair means of distributing such royalties to copyright owners and performers, and better than any other reasonably available alternative. SoundExchange urges the Judges to make that possible promptly.

IV. **CONCLUSION**

For the reasons set forth above, SoundExchange respectfully requests that the Judges promptly commence a rulemaking proceeding to consider the regulatory changes set forth in Exhibit A, and at the conclusion thereof, grant SoundExchange authority to distribute pre-2010 statutory license royalties that are not then distributable because the licensees have not provided reports of use.⁶

⁶ Other notice and recordkeeping issues that may warrant treatment in a rulemaking proceeding have been identified. *E.g.*, 74 Fed. Reg. 52,418, 52,423 (Oct. 13, 2009) (indicating that certain issues raised in the 2009 rulemaking "may merit further examination in a future rulemaking"); 76 Fed. Reg. at 13,045 (Mar. 9, 2011) (certain issues "more appropriately addressed in a future rulemaking proceeding"). SoundExchange contemplates requesting a proceeding to consider issues of this nature, but does not believe that consideration of this narrow request for limited retroactive proxy distribution authority should be delayed by the possibility of a broader inquiry at a later time.

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Respectfully submitted,



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Exhibit A
Proposed Regulations

1. Amend 37 C.F.R. Part 370.3 by adding at the end the following new subsection:

“(i) In any case in which a preexisting subscription service has not provided a report of use required under this section for use of sound recordings under section 112(e) or section 114 of title 17 of the United States Code, or both, prior to January 1, 2010, reports of use for the corresponding calendar year filed by other preexisting subscription services shall serve as the reports of use for the non-reporting service, solely for purposes of distribution of any corresponding royalties by the Collective.”

2. Amend 37 C.F.R. Part 370.4 by adding at the end the following new subsection:

“(f) In any case in which a nonsubscription transmission service, preexisting satellite digital audio radio service, new subscription service, or business establishment service has not provided a report of use required under this section for use of sound recordings under section 112(e) or section 114 of title 17 of the United States Code, or both, prior to January 1, 2010, reports of use for the corresponding calendar year filed by other services of the same type shall serve as the reports of use for the non-reporting service, solely for purposes of distribution of any corresponding royalties by the Collective.”

3. Because of the renumbering of the notice and recordkeeping provisions in Docket No. RM 2008-7, certain royalty distribution provisions that point to Part 370 to identify the reports of use to be used by SoundExchange in distributing royalties no longer identify the correct corresponding provisions. For the royalty distribution provisions to correctly reflect the notice and recordkeeping regulations proposed to be amended above, the following technical corrections should be made:⁷

- A. Amend 37 C.F.R. § 382.3(c)(1) by striking “§ 370.2” and inserting “§ 370.3”.
- B. Amend 37 C.F.R. § 382.13(f)(1) by striking “§ 370.3” and inserting “§ 370.4”.

⁷ A similar change in 37 C.F.R. § 380.4(g)(1) was made in the *Webcaster III* proceeding. 76 Fed. Reg. at 13,049 (§ 380.4(g)(1)).