



This document is scheduled to be published in the Federal Register on 05/09/2013 and available online at <http://federalregister.gov/a/2013-11020>, and on FDsys.gov

LIBRARY OF CONGRESS

U.S. Copyright Office

37 CFR Part 201

Docket No. 2012-5

Verification of Statements of Account Submitted by Cable Operators and Satellite Carriers

AGENCY: U.S. Copyright Office, Library of Congress.

ACTION: Notice of proposed rulemaking; request for comments.

SUMMARY: On June 14, 2012, the United States Copyright Office published a notice of proposed rulemaking and request for comments concerning a new regulation that will allow copyright owners to audit the Statements of Account and royalty fees that cable operators and satellite carriers deposit with the Copyright Office for secondary transmissions of broadcast programming made pursuant to statutory licenses. The Copyright Office has revised the proposed regulation based on comments that it received from copyright owners, cable operators, and satellite carriers. The Copyright Office seeks comments on the revised proposal before it is adopted as a final rule.

DATES: Comments on the revised proposal must be received in the Office of the General Counsel of the Copyright Office no later than 5 pm Eastern Daylight Time (EDT) on [insert date 30 days after the date of publication in the *Federal Register*]. Reply comments must be received in the Office of the General Counsel no later than 5 pm EDT on [insert date 45 days after the date of publication in the *Federal Register*].

ADDRESSES: The Copyright Office strongly prefers that comments be submitted electronically. A comment submission page is posted on the Copyright Office website at www.copyright.gov/docs/soaaudit/comments/submission/. The website interface requires submitters to complete a form specifying name and other required information, and to upload comments as an attachment. To meet accessibility standards, all comments must be uploaded in a single file in either the Portable Document Format (PDF) that contains searchable, accessible text (not an image); Microsoft Word; WordPerfect; Rich Text Format (RTF); or ASCII text file format (not a scanned document). The maximum file size is 6 megabytes (MB). The name of the submitter and organization should appear on both the form and the face of the comments. All comments will be posted publicly on the Copyright Office website exactly as they are received, along with names and organizations if provided. If electronic submission of comments is not feasible, please contact the Copyright Office at (202) 707–8380 for special instructions.

FOR FURTHER INFORMATION CONTACT: Erik Bertin, Attorney Advisor, Copyright GC/I&R, P.O. Box 70400, Washington, DC 20024. *Telephone:* (202) 707–8380. *Telefax:* (202) 707–8366.

SUPPLEMENTARY INFORMATION:

I. Background.

Sections 111 and 119 of the Copyright Act (“Act”), title 17 of the United States Code, allow cable operators and satellite carriers to retransmit the performance or display of works embodied in a primary transmission made by a broadcast station licensed by the Federal Communications Commission. In order to use the statutory licenses, cable operators and satellite carriers are required to file Statements of Account and deposit royalty fees with the Copyright Office (“Office”) on a semi-annual basis. The Office invests these royalties in United States

Treasury securities pending distribution of the funds to copyright owners who are entitled to receive a share of the royalties.

In 2010, Congress enacted the Satellite Television Extension and Localism Act of 2010 (“STELA”), Pub. L. No. 111-175 which, *inter alia*, directed the Register of Copyrights to develop a new procedure for verifying the Statements of Account and royalty fees that cable operators and satellite carriers deposit with the Office. Specifically, section 119(b)(2) directed the Register to “issue regulations to permit interested parties to verify and audit the statements of account and royalty fees submitted by satellite carriers under [that] subsection.” Similarly, section 111(d)(6) directed the Register to “issue regulations to provide for the confidential verification by copyright owners whose works were embodied in the secondary transmissions of primary transmissions pursuant to [section 111] of the information reported on the semiannual statements of account filed under this subsection for accounting periods beginning on or after January 1, 2010, in order that the auditor designated under subparagraph [111(d)(6)(A)] is able to confirm the correctness of the calculations and royalty payments reported therein.”

On June 14, 2012, the Office published a Notice of Proposed Rulemaking and Request for Comments on a regulation that would implement sections 111(d)(6) and 119(b)(2) of the Copyright Act. *See* 77 FR 35643, June 14, 2012. The proposed regulation was based on similar regulations that the Office developed for parties that make ephemeral recordings or transmit digital sound recordings under 17 U.S.C. sections 112(e) and 114(f), respectively, or manufacture, import, and distribute digital audio recording devices under 17 U.S.C. chapter 10. *See id.* at 35644. The Office also considered a Petition for Rulemaking, which offered proposals

from a group of copyright owners who are the beneficiaries of the royalties paid under the statutory licenses (“Copyright Owners”).¹

The Office received comments on the proposed regulation from groups representing copyright owners, cable operators,² and individual companies that retransmit broadcast programming under section 111 or 119 of the Act, namely, AT&T, Inc., DIRECTV, LLC (“DTV”), and DISH Network L.L.C. (“DISH”). While the parties agreed on the overall framework that the Office proposed for the verification procedure, they strongly disagreed on a number of key issues, such as the procedures for selecting an auditor, for expanding the scope of the audit, and for allocating the cost of the verification procedure.

On August 24, 2012 and again on September 26, 2012, the National Cable & Telecommunications Association (“NCTA”), the Joint Sports Claimants, and the Program Suppliers submitted a joint motion to extend the deadline for submitting reply comments.³ They explained that there might be common ground among the moving parties concerning certain aspects of the proposed regulation. If so, the moving parties stated that they might be able to narrow the issues that they discuss in their reply comments, which in turn, might narrow the issues that need to be resolved in this rulemaking. The Office granted these motions, making reply comments due by October 24, 2012. *See* 77 FR 55783, Sept. 11, 2012; 77 FR 60334, Oct. 3, 2012.

¹ The petition was filed on behalf of Program Suppliers (commercial entertainment programming), Joint Sports Claimants (professional and college sports programming), Commercial Television Claimants (local commercial television programming), Music Claimants (musical works included in television programming), Public Television Claimants (noncommercial television programming), Canadian Claimants (Canadian television programming), National Public Radio (noncommercial radio programming), Broadcaster Claimants Group (U.S. commercial television stations), and Devotional Claimants (religious television programming). A copy of the petition has been posted on the Copyright Office website at <http://www.copyright.gov/docs/soaaudit/soa-audit-petition.pdf>.

² The National Cable & Telecommunications Association (“NCTA”) and the American Cable Association (“ACA”) filed comments on behalf of cable operators.

³ The NCTA is a trade association that represents cable operators. The Joint Sports Claimants represent copyright owners that produce professional and college sports programming. The Program Suppliers represent copyright owners that produce and/or syndicate movies, programs, and specials that are broadcast by television stations.

In lieu of reply comments, NCTA, DIRECTV, and a group representing certain copyright owners⁴ submitted a joint proposal for revising the proposed regulation (hereinafter the “Joint Stakeholders’ Proposal”).⁵ The Joint Stakeholders stated that their Proposal adopts “the general framework” set forth in the Notice of Proposed Rulemaking and in other verification procedures that the Office has adopted in the past. They also stated that their Proposal has been “carefully tailored” to reflect “the unique characteristics of the cable and satellite compulsory licenses,” and reflects “significant compromises by all parties with the objective of securing a workable set of audit procedures consistent with STELA.” (Joint Stakeholders Reply at 2.)

The Office also received reply comments from AT&T. Although it was aware of the Joint Stakeholders’ negotiations and the areas of agreement among the parties, AT&T explained that it was not in a position to endorse the Joint Stakeholders’ Proposal, because it was not given a sufficient amount of time for “meaningful engagement” with the group. (AT&T Reply at 1.) Therefore, AT&T urged the Office to publish the Joint Stakeholders’ Proposal “for further comment by other interested parties who were not parties to the agreement.” *Id.*

The Office carefully reviewed all of the comments and reply comments that were submitted in this proceeding, including the Joint Stakeholders’ Proposal.⁶ The Joint Stakeholders’ Proposal addresses most of the concerns that the parties raised in their initial comments, and for the most part, it balances those concerns in an appropriate manner. Therefore,

⁴ This group includes the Program Suppliers, Joint Sports Claimants, Public Television Claimants, Canadian Claimants Group, Devotional Claimants, National Public Radio, and Music Claimants. The Commercial Television Claimants and the Broadcaster Claimants Group did not join their fellow copyright owners in submitting this proposal.

⁵ A copy of the Joint Stakeholders’ Proposal has been posted on the Copyright Office website at http://www.copyright.gov/docs/soaaudit/comments/reply/joint_stakeholders.pdf. It includes a redline showing the differences between the Joint Stakeholders’ Proposal and the proposed regulation set forth in the Notice of Proposed Rulemaking published on June 14, 2012.

⁶ All of the comments and reply comments have been posted on the Copyright Office website at <http://www.copyright.gov/docs/soaaudit/comments/index.html>.

the Office has incorporated most of the Joint Stakeholders' suggestions into the proposed regulation, which is referred to herein as the "Revised Proposal."

The Office recognizes that ACA, AT&T, DISH, the Broadcaster Claimants Group, the Commercial Television Claimants, and other interested parties did not participate in the Joint Stakeholders' negotiations. Because the Revised Proposal includes proposed changes offered by the Joint Stakeholders, the Office concludes that other interested parties should be given an opportunity to comment on the proposed regulation before the Office adopts a final rule. The Office also welcomes reply comments on the Revised Proposal from the Joint Stakeholders or other interested parties. Commenters should limit their remarks to issues raised by the Revised Proposal which were not discussed in the initial comments, the reply comments, or this *Federal Register* notice, while reply commenters should limit their remarks to the issues or concerns presented in the follow-up comments.

II. Areas of Common Agreement Among the Parties

Generally speaking, the parties agreed with the overall framework that the Office proposed for the audit regulation. They agreed that the Office should create a single verification procedure applicable to cable operators and satellite carriers alike. (*See* Copyright Owners at 3, 4, 8; DTV at 1-2.) They agreed that copyright owners should initiate a verification procedure by filing a notice of intent to audit with the Office, and that the notice must be received within three years after the last day of the year in which the licensee filed its Statements of Account. They agreed that the verification should be conducted by a certified public accountant, and that a single auditor should conduct the audit on behalf of all copyright owners (regardless of whether they decide to join the audit or not). (*See* AT&T at 2, 3; DISH at 8-9.) They agreed that satellite carriers and cable operators that own a single system should be subject to no more than one audit

per year. They agreed that an audit involving a multiple system operator should be limited to a sampling of the systems owned by that entity. (*See* NCTA at 6.) They agreed that 30 days would be a sufficient amount of time for the auditor to consult with the statutory licensee’s designee concerning the conclusions set forth in the initial draft of the auditor’s report. They agreed that the auditor should be allowed to deliver his or her final report to the copyright owners without consulting with the statutory licensee if the auditor suspects that the licensee has engaged in fraud. They also agreed that statutory licensees should be required to retain records needed to confirm the correctness of the calculations and royalty payments reported in a Statement of Account for at least three and a half years after the last day of the year in which the Statement was filed with the Office. (*See* DISH at 7.)

III. Retroactivity

A. Comments

As discussed above, the Office received a Petition for Rulemaking on January 31, 2012, which was filed on behalf of groups that represent copyright owners (collectively “the Petitioners”). Among other things, the Petitioners urged the Office to establish separate procedures for verifying Statements of Account filed under section 111 and 119, and they provided the Office with draft regulations for audits involving cable operators and satellite carriers.

The Office did not adopt this approach in its Notice of Proposed Rulemaking. If the Office followed the Petitioners’ recommendation, the regulation for cable operators would apply to Statements of Account for accounting periods beginning on or after January 1, 2010 (*i.e.*, the

semiannual accounting period that was in effect when the President signed STELA into law on May 27, 2010), while the regulation for satellite carriers would apply to any Statement of Account, even if the Statement was filed before STELA was enacted. In other words, the regulation for satellite carriers would apply retroactively, while the regulation for cable operators would apply on a prospective basis only. *See* 77 FR 35645, June 14, 2012.

DTV agreed that the Office should “harmonize” the procedures for cable operators and satellite carriers, and noted that “there are strong policy reasons not to apply laws retroactively.” (DTV at 2.) DISH agreed that the regulation should not apply to Statements of Account for accounting periods that pre-date STELA, and further asserted that the proposed regulation should apply only to Statements of Account filed on or after the date that the final rule goes into effect. (DISH at 3.) While the Copyright Owners agreed that the Office should adopt a uniform procedure for both cable operators and satellite carriers, they contended that a regulation allowing for the verification of pre-2010 Statements of Account would not constitute a retroactive obligation. (Copyright Owners at 4.)

B. Discussion

The Revised Proposal would allow copyright owners to audit Statements of Account filed by cable operators and satellite carriers for accounting periods beginning on or after January 1, 2010. The Office has concluded that this would not be a retroactive regulation, even though it would apply to Statements for the 2010, 2011, and 2012 accounting periods.

A regulation is retroactive if it “takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past.” *National Mining Ass’n v. Dep’t of Labor*, 292 F.3d 849, 859 (D.C. Cir. 2002). The fact that the regulation establishes a procedure for

verifying Statements of Account filed before the date that the final rule goes into effect does not mean it is retroactive. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 269-70 (1994) (a law is not considered retroactive “merely because it is applied in ‘a case arising from conduct antedating the statute’s enactment”). Instead, “the operative inquiry is ‘whether the new provision attaches new legal consequences to events completed before its enactment.’” *Id.*

Neither DISH nor any other party has identified any aspect of the proposed regulation that changes the legal landscape for satellite carriers or cable operators. The regulation creates a framework for audits that will be conducted in the future, but it does not change the “past legal consequences of past actions” for a statutory licensee who may be subject to the verification procedure. *See National Petrochemical & Refiners Ass’n v. EPA*, 630 F.3d 145, 161 (D.C. Cir. 2010). The regulation states that the auditor will review a Statement of Account to determine whether the licensee correctly calculated, reported, and paid the amount which was due. If the auditor discovers an error or underpayment, the licensee would be subject to the same legal obligations which would apply if the error had been discovered when the Statement was filed.⁷ Moreover, cable operators and satellite carriers that use the statutory license knew that copyright owners would be entitled to audit Statements of Account following the enactment of STELA, and as such, were on notice that Statements filed on or after the effective date might be subject to this procedure. Indeed, some of the parties who submitted comments in this proceeding stated that they were “intimately” and “directly” involved in the negotiations that preceded the drafting of STELA. *See DTV at 1-2; Refunds Under the Cable Statutory License*, Docket No. RM-2010-

⁷ The cases cited by DISH are distinguishable because they involve situations where “an agency completely reversed the status quo ante.” *See Nat’l Petrochemical & Refiners Ass’n*, 630 F.3d at 160 (distinguishing *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988) and *Nat’l Mining Ass’n v. Dep’t of Labor*, 292 F.3d 849 (D.C. Cir. 2002)). For example, in *Bowen* the agency required a party to return or forfeit money that it had received from the government. In *Marrie v. SEC*, 374 F.2d 1196 (D.C. Cir. 2004), the agency changed the legal standard needed to establish professional misconduct, and then applied that standard to conduct that occurred before the rule was adopted.

3, Comments of National Cable & Telecommunications Association at 3 (available at <http://www.copyright.gov/docs/stela/comments/ncta-11-03-10.pdf>).

IV. Initiation of an Audit

A. Comments

In the Notice of Proposed Rulemaking the Office explained that a copyright owner could initiate an audit procedure by filing a notice with the Office, which would be published in the *Federal Register*. The copyright owner would be required to identify the Statement(s) of Account and accounting period(s) that would be included in the audit, and the statutory licensee that filed those Statement(s) with the Office. In addition, the notice would have to provide contact information for the copyright owner filing the notice, and a brief statement establishing that it owns at least one work that was embodied in a secondary transmission made by that licensee. A notice of intent to audit a particular Statement of Account would be considered timely if it is received within three years after the last day of the year in which that Statement was filed.

Any other copyright owner that wishes to participate in the audit would have to notify both the copyright owner that filed the notice of intent to audit and the statutory licensee who would be subject to the audit within 30 days after the notice was published in the *Federal Register*. Copyright owners that join in the audit would be entitled to participate in the selection of the auditor, they would be entitled to receive a copy of the auditor's report, and they would usually be required to pay for the auditor for his or her work in connection with the audit.⁸ However, a copyright owner that failed to join the audit within the time allowed would not be permitted to participate in the selection of the auditor and would not be entitled to receive a copy of the auditor's report. Moreover, a copyright owner that failed to join the audit would not be

⁸ These parties are defined in the Revised Proposal as the "participating copyright owner(s)."

permitted to conduct its own audit of the semiannual Statement(s) of Account identified in the *Federal Register* notice at a later time.

All of the parties agreed with this approach, although the Copyright Owners suggested that a group representing multiple copyright owners should be permitted to file a notice of intent to audit on behalf of the members of that group. (Copyright Owners at 4-5.)

B. Discussion

Generally speaking, the Revised Proposal follows the same approach for initiating an audit that the Office proposed in its Notice of Proposed Rulemaking. As the Copyright Owners suggested, the term “copyright owners” is defined to mean “a person or entity that owns the copyright in a work embodied in a secondary transmission made by a statutory licensee” or “a designated agent or representative of such person or entity.” This will allow groups representing multiple copyright owners to file a notice of intent to audit, provided that the groups represent at least one party who owns a work which was embodied in a secondary transmission made by the statutory licensee during one or more of the accounting periods specified in the notice. It will also allow groups representing multiple copyright owners to prepare a list of qualified and independent auditors who may be selected to conduct the audit, to expand the scope of the audit if the auditor discovers an underpayment that exceeds a certain threshold, to prepare an itemized report documenting the cost of the audit, among other activities contemplated by the Revised Proposal.

V. Designation of the Auditor

A. Comments

In the Notice of Proposed Rulemaking, the Office suggested that the copyright owners should be solely responsible for selecting a qualified and independent auditor to conduct the

verification, and that any disputes concerning the auditor's qualifications or independence should be resolved by the Professional Ethics Division of the American Institute of Certified Public Accountants ("AICPA") or the State Board of Accountancy that licensed the auditor while the audit is underway. Many of the parties disagreed with this approach.

The Copyright Owners predicted that this would lead to needless delay and expense. They stated that a statutory licensee should be required to raise any concerns about the auditor in a prompt manner, and that if the parties are unable to resolve their differences within 30 days, the auditor should be allowed to proceed with the verification. (Copyright Owners at 5.) AT&T agreed that any disputes concerning the qualifications or independence of the auditor should be resolved before the audit begins, and further stated that if the auditor is not qualified or independent, the statutory licensee should not be subject to any audits until the following year. (AT&T at 4; AT&T Reply at 2.) The NCTA stated that an auditor selected by the copyright owners could be biased in favor of his or her clients. To address these concerns, the NCTA suggested that both the copyright owners and the statutory licensee should designate a certified independent accountant, who, in turn, would select a neutral auditor to conduct the verification procedure. (NCTA at 4-5.)

Regarding the auditor's qualifications, AT&T agreed that the audit should be conducted by a certified public accountant who is in good standing with the AICPA. AT&T stated that the auditor should not be subject to any disciplinary inquiry or proceeding, that the auditor should not be allowed to collect a contingency fee based on the results of the audit, and that the auditor should be required to file a certification with the Office confirming his or her qualifications and independence before the audit begins. (AT&T at 3-4; AT&T Reply at 2.)

B. Discussion

The Revised Proposal addresses the parties' concerns regarding the selection of the auditor. Copyright owners who wish to participate in the audit would provide the statutory licensee with a list of three independent and qualified auditors, along with information that would be reasonably sufficient for the licensee to evaluate the independence and qualifications of each individual. Specifically, the copyright owners would provide the licensee with a copy of the auditor's *curriculum vitae*, a copy of the engagement letter that would govern his or her performance of the audit, and a list of any other audits that the auditor has conducted under this regulation. They would also provide a brief description of any other work that the auditor has performed for any of the participating copyright owners within the previous two calendar years, along with a list of the participating copyright owners who have engaged the auditor's firm within the previous two calendar years.

Within five (5) business days after receiving this information, the statutory licensee would be required to select one of these auditors. That individual would audit the licensee's Statements of Account on behalf of all copyright owners who own a work that was embodied in a secondary transmission made by that licensee during the accounting period(s) subject to the audit.⁹ To ensure that the auditor maintains his or her independence during the audit, the Revised Proposal explains that there may be no *ex parte* communications between the auditor and the participating copyright owners or their representatives until the auditor has issued his or her final report. However, there are two exceptions to this rule. The auditor may communicate

⁹ The Revised Proposal differs from the Joint Stakeholders' Proposal by clarifying that the auditor would initially only be authorized to verify the Statement(s) of Account which were listed in the notice of intent to audit. As discussed in section VIII(B), if the auditor discovers an underpayment that meets or exceeds a certain threshold, the auditor would be permitted to expand the scope of the audit to include other Statements which were not mentioned in the initial notice.

directly with the copyright owners if he or she has a reasonable basis to suspect that the statutory licensee has committed fraud, or if the auditor gives the licensee an opportunity to participate in the communication and the licensee declines to do so.

In response to AT&T's concerns, the Revised Proposal states that the auditor must be a member in good standing with the AICPA and the relevant licensing authority for the jurisdiction(s) where the auditor practices,¹⁰ and it states that the auditor must be compensated with a flat fee or based on an hourly rate, rather than a contingency fee.¹¹

The Office declined to adopt AT&T's suggestion that the auditor should not be subject to "any disciplinary inquiry or proceeding." (AT&T at 3, emphasis added.) It is implicit that the auditor is not currently subject to a disciplinary inquiry or proceeding, because the regulation requires that the auditor must be a member in good standing with the relevant licensing authority and professional association for certified public accountants. In any event, it seems unlikely that the copyright owners would invite a "peremptory challenge" by nominating an accountant who is currently suspended or subject to a pending disciplinary inquiry or proceeding.¹² Likewise, the Office does not believe that the auditor should be required to file a certification with the Office concerning his or her qualifications and independence, because the Revised Proposal already

¹⁰ The licensing requirements for a CPA are set and enforced by the Board of Accountancy for the jurisdiction(s) where the CPA practices (rather than the AICPA). However, CPAs who join the AICPA agree to abide by the Code of Professional Conduct and Bylaws (the "Code") that have been adopted by the organization. "The bylaws provide a structure for enforcement of the Code by the Institute's Professional Ethics Division. When allegations come to the attention of the Ethics Division regarding a violation of the Code, the division investigates the matter, under due process procedures, and depending upon the facts found in the investigation, may take a confidential disciplinary action, settle the matter with suspension or revocation of membership rights, or refer the matter to a panel of the Trial Board Division for a hearing." See AICPA, FAQs – Become a CPA, available at <http://www.aicpa.org/BecomeACPA/FAQs/Pages/FAQs.aspx>.

¹¹ According to the AICPA, 47 states and jurisdictions allow CPAs to accept contingency fees, except in situations where the CPA audits or reviews a financial statement or prepares an original tax return. See AICPA Code of Professional Conduct, Rule 302 – Contingent Fees, available at http://www.aicpa.org/research/standards/codeofconduct/pages/et_302.aspx; see also AICPA, Commissions and Contingent Fees, available at <http://www.aicpa.org/Advocacy/State/Pages/CommissionsandContingentFees.aspx>

¹² To be clear, an auditor who has been subject to a disciplinary inquiry or proceeding at some point in the past would not necessarily be disqualified from conducting an audit under this procedure.

directs the copyright owners to provide the statutory licensee with information that it reasonably needs to evaluate each auditor.

VI. Scope of the Audit and Time Period for Conducting an Audit

A. Comments

The Notice of Proposed Rulemaking did not specify a precise deadline for when the audit should begin or when the audit should be completed, because the Office expects that the issues presented in each audit will vary depending on the number and complexity of the Statements of Account that will be subject to review. For the same reason, the Office did not specify the precise issues that the auditor should consider in each audit. Instead, the Notice of Proposed Rulemaking simply stated that the audit should be performed in accordance with generally accepted auditing standards. *See* 77 FR 35647, June 14, 2012. Many of the parties criticized this approach.

In order to avoid “needless delay and added expense,” the Copyright Owners contended that the statutory licensee should be given a 30 to 90 day deadline to provide the auditor with the information he or she needs to conduct the verification procedure. (Copyright Owners at 6.) DISH predicted that the statutory licensee would have to “devote certain resources to ensuring compliance with the auditor’s needs,” and that the “longer the auditing process is stretched out, the greater the resource strain.” Therefore, DISH said that the auditor should be given a precise deadline for completing the verification process. (DISH at 6.)

DISH also contended that the auditor should not conduct a deep and burdensome “inquiry into the cable or satellite carrier’s business operations or processes.” Instead, he or she should simply confirm that the licensee correctly identified the network and non-network transmissions carried by that licensee during the relevant time period and confirm that the licensee correctly

multiplied the number of subscribers who receive each transmission by the applicable royalty rate. (DISH at 5-6.) AT&T expressed a similar concern. Citing the Office's audit regulations for digital audio recording devices, it asserted that the auditor should review the information that the statutory licensee provides in its Statement of Account, but should not consider any discrepancies that appear on the face of each Statement or any aspect of the Statement that is reviewed by the Licensing Division, such as the classification of stations as distant, local, permitted, or non-permitted. AT&T also contended that statutory licensees should not be required to provide the auditor with information concerning individual subscribers. (AT&T at 3, 4; AT&T Reply at 4.)

Both AT&T and the NCTA stated that the audit should be conducted during normal business hours in order to expedite the audit process and to minimize the disruption to the statutory licensee's business. (AT&T at 9; NCTA at 8.) In addition, AT&T contended that the statutory licensee should be given 60 days to respond to the auditor's request for information, and that the licensee should not be required to respond to such requests within 75 days before the due date for a semiannual Statement of Account "when individuals with the most knowledge are fully occupied with meeting filing requirements." (AT&T at 9.)

B. Discussion

The Revised Proposal addresses the parties' concerns regarding the scope and duration of the audit. The statutory licensee would be given more than two months notice to identify and collect information that may be relevant to the audit. Specifically, the copyright owner would be required to serve a notice of intent to audit on the licensee that identifies the Statements of Account that will be reviewed by the auditor. At least 30 days would pass before other participating copyright owners would be required to notify the licensee of their intent to join the

audit. The licensee would be given at least 5 business days to select the auditor who would conduct the verification procedure and another 30 days thereafter to provide the auditor with a list of the broadcast signals that the licensee retransmitted during the accounting period(s) at issue in the audit. So as a practical matter, the licensee would have at least 65 days to prepare before the audit gets underway.

After the auditor has been selected, the licensee would be required to provide the auditor and a representative of the participating copyright owners with a certified list of the broadcast signals retransmitted under each Statement of Account that is at issue in the audit, including the call sign for each broadcast signal and each multicast signal. In addition, cable systems and multiple system operators (“MSOs”) would be required to identify the classification of each signal on a community by community basis pursuant to §§ 201.17(e)(9)(iv)-(v) and 201.17(h) of the regulations.

The Joint Stakeholders included similar language in their proposal,¹³ and the Office assumes that this provision is intended to respond to the Copyright Owners’ request that statutory licensees be given a precise deadline for providing information that the auditor needs to conduct the verification procedure. However, the Office notes that statutory licensees already provide this information in the Statements of Account that they file with the Licensing Division, and that the person signing the Statement must certify, under penalty of law pursuant to title 18 of the U.S. Code, that this information is true, correct, and complete. Although the Office included this requirement in the Revised Proposal, the Office seeks comment on whether there is any benefit in requiring licensees to provide information that should be apparent from the face of their Statements of Account.

¹³ The primary difference is that the Revised Proposal would impose this requirement on satellite carriers, cable systems, and MSOs alike, while the provision in the Joint Stakeholders’ Proposal only applied to cable operators and MSOs.

The Revised Proposal would allow the statutory licensee to suspend an audit for up to 30 days before the due date for filing a semiannual Statement of Account,¹⁴ although the licensee would not be allowed to exercise this option once the auditor has delivered the initial draft of his or her report to the licensee.¹⁵ At the same time, the Revised Proposal protects the interests of the copyright owners by requiring the licensee to execute an agreement tolling the statute of limitations for no more than 30 days if the copyright owners believe in good faith that the suspension could prevent the auditor from delivering his or her final report before the statute of limitations expires.

The Revised Proposal differs from the Joint Stakeholders' proposal insofar as the Joint Stakeholders would have allowed the statutory licensee to suspend the audit for up to 60 days before the deadline for filing a semiannual Statement of Account. Given that the copyright owners may conduct only one audit per year, the Office believes that it would be unduly restrictive to impose a "blackout period" on the auditor for up to four months of the year.

DISH contended that the auditor should be given a precise deadline for completing the audit, but this does not appear to be necessary. As discussed in section VIII(B), a statutory licensee would be subject to no more than one audit per calendar year. In other words, if the copyright owners launched an audit on January 1, 2014 and if that audit was still ongoing as of January 1, 2015, the copyright owners would not be allowed to conduct another audit of that licensee until January 1, 2016. As a result, the copyright owners would have a strong incentive to complete each audit before the end of the calendar year.

¹⁴ In other words, satellite carriers could suspend an audit from January 1st through January 30th and from July 1st through July 30th, while cable operators could suspend an audit from January 28th through February 28th (in a non-leap year) and from July 31st through August 29th.

¹⁵ This limitation is discussed in more detail in section IX(B).

The Revised Proposal specifically states that the statutory licensee must provide the auditor with reasonable access to the licensee's books, records, or other information that the auditor needs in order to conduct the audit. The Revised Proposal protects the licensees' interests by providing that the audit must be conducted during normal business hours at a location designated by the licensee, that consideration must be "given to minimizing the costs and burdens associated with the audit," and that the licensee is only required to provide the auditor with information that he or she "*reasonably* requests" (emphasis added). This should address DISH's concern that the verification procedure might lead to a "deep and burdensome inquiry" into a licensee's business operations or processes. (DISH at 5-6.) The Revised Proposal also requires the auditor to safeguard any confidential information that he or she may receive from the licensee. This should address AT&T's concern that cable operators might be asked to provide the auditor with information concerning individual subscribers.

Finally, AT&T contended that the auditor should review the information that the licensee provided in its Statement of Account, but should not consider any discrepancies that appear on the face of the Statement or any aspect of the Statement that is reviewed by the Licensing Division, such as the classification of stations as distant, local, permitted, or non-permitted, or other discrepancies. The Revised Proposal addresses this concern by requiring that the auditor verify "all information reported on the Statements of Account subject to the audit in order to confirm the correctness of calculations and royalty payments reported therein." However, the auditor shall not determine whether a cable system properly classified any broadcast signal under §§ 201.17(e)(9)(iv)-(v) and 201.17(h) of the regulations or whether a satellite carrier properly determined that any subscriber or group of subscribers is eligible to receive broadcast signals under section 119(a) of the Act.

VII. Retention of Records

A. Comments

The Notice of Proposed Rulemaking explained that a statutory licensee would be required to retain any records needed to confirm the correctness of the calculations and royalty payments reported in its Statements of Account for at least three and a half years after the last day of the year in which the Statement was filed with the Office. The Office also explained that a licensee who has been subject to an audit would be required to retain those records for at least three years after the date that the auditor delivers his or her final report to the copyright owners who decided to participate in the audit.

Generally speaking, the parties did not object to this proposal. The Copyright Owners opined that when a statutory licensee files an amended Statement of Account, the deadline for maintaining records should be calculated from the date that the amendment is filed rather than the date of the initial Statement. (Copyright Owners at 6.) DISH stated that if the auditor determines that the statutory licensee correctly reported the royalties due on a particular Statement of Account the licensee should not be required to retain its records concerning that Statement once the auditor has delivered his or her final report to the copyright owners. (DISH at 7-8.)

B. Discussion

In response to the Copyright Owners' concerns, the Revised Proposal specifies that the deadline for maintaining records for an amended Statement of Account should be calculated from the date that the amendment was filed rather than the filing date for the initial Statement.

The Office is concerned that the one-year retention period proposed by the Joint Stakeholders would deprive copyright owners of the benefits of the three-year statute of

limitations and it would create confusion for statutory licensees (with a one year retention period for Statements of Account that have been audited, and a three year retention period for Statements that could potentially be subject to an audit). Therefore, the proposed regulation states that a licensee who has been subject to an audit would be required to retain any records needed to confirm the correctness of the calculations and royalty payments reported in a Statement of Account for at least three years after the date that the auditor delivers his or her final report to the copyright owners. The Office weighed DISH's concerns, but concluded that a licensee should be required to retain its records even if the auditor finds no discrepancies in the Statements of Account, to ensure that the licensee does not discard its records before the copyright owners have had an opportunity to review the auditor's report.

VIII. Frequency of the Audit Procedure

A. Comments

In its Notice of Proposed Rulemaking, the Office suggested that a satellite carrier or a cable operator that owns one cable system should be subject to no more than one audit per year. By contrast, an operator that owns more than one system would be subject to no more than three audits per year. In order to protect the interests of multiple system operators, the Office explained that the auditor would review a sampling of the systems owned by each MSO. To protect the interests of copyright owners, the Office explained that if the auditor discovers an underpayment of 5 percent or more in a Statement of Account filed by an MSO, the size of the sample could be expanded to include any and all of the systems owned by that operator.

The Office explained that the Notice of Proposed Rulemaking was merely a starting point for further discussion on these issues, and invited comment from interested parties concerning the limit on the total number of audits that an MSO should be required to undergo in a single

year. *See* 77 FR 35647, June 14, 2012. The Office invited comments on whether an audit involving 50 percent of the systems owned by a particular operator would be likely to produce a statistically significant result. It also invited comments on whether a 50 percent threshold would be unduly burdensome for MSOs and, if so, what percentage would be appropriate. *See id* at 35648.

The Copyright Owners did not object to the proposed limit on the number of audits that an MSO would be required to undergo, but recommended that the Office define the term “multiple system operator” to avoid any confusion about which systems would be covered by this aspect of the regulation. (Copyright Owners at 7.) AT&T stated that an MSO should be subject to no more than one audit per year and that each audit should be limited to no more than two Statements of Account, noting that this would be consistent with verification procedures that the Office has adopted in the past. (AT&T at 2.) The NCTA expressed the same view, but stated that each audit should be limited to no more than one Statement of Account. (NCTA at 6, 7.)

The NCTA and AT&T agreed that an audit involving an MSO should be based on a reasonable sampling of the systems owned by that entity. (AT&T at 3; NCTA at 6.) AT&T explained that an audit involving 50 percent of its systems “would cause substantial burden and disruption” and stated that the accuracy of its Statements of Account could be determined based on a “substantially smaller sample.” (AT&T at 3.) While AT&T did not propose a specific number or percentage of systems that should be included in each audit, the NCTA stated that a representative sample of 10 percent or less would be consistent with audit practices and “should be more than sufficient to determine whether an MSO’s SOAs suffer from any systemic problems.” (NCTA at 6.)

The Copyright Owners agreed that if the auditor discovers an underpayment of 5 percent or more in an audit of an MSO, the auditor should be allowed to expand the scope of the audit to include all of the systems owned by that operator. (Copyright Owners at 7.) AT&T did not object to the idea of expanding the number of systems subject to the audit, but stated that an expanded audit should require a showing of good cause. Specifically, AT&T stated that the amount of the underpayment should exceed a minimum threshold and a minimum percentage in order to trigger an expanded audit, and that discrepancies that appear on the face of a Statement of Account or discrepancies based on “reasonable disagreements about issues of law, construction of regulations, or accounting procedures” should not be included in this calculation. In addition, AT&T stated that the Office should create a separate procedure for resolving good faith disputes over legal, regulatory, and accounting issues before the copyright owners are allowed to expand the scope of an audit. (AT&T at 8, 9.)

The NCTA categorically opposed the idea of expanding the scope of an audit involving an MSO. It asserted that there is no need to audit more than 10 percent of the systems owned by an MSO, because a sample of 10 percent of those systems should disclose any systemic problems in the operator’s royalty calculations. The NCTA also asserted that it would be unreasonable to allow an “isolated underpayment” in a single Statement of Account to trigger an audit of all of the systems owned by that operator. (NCTA at 6-7.)

B. Discussion

The Revised Proposal states that statutory licensees would be subject to no more than one audit per calendar year (regardless of the number of cable systems that they own) and the audit of a particular satellite carrier or cable system would be limited to no more than two of the Statements of Account submitted by that licensee.

In response to the concerns expressed by AT&T and the NCTA, the Revised Proposal explains that an audit involving an MSO would be limited to a sampling of the systems owned by that entity. Specifically, the auditor would be permitted to verify the Statements of Account filed by no more than 10 percent of the Form 2 and 10 percent of the Form 3 systems owned by an MSO. In order to avoid any confusion about which systems would be subject to this procedure, the Revised Proposal explains that the term MSO means “an entity that owns, controls, or operates more than one cable system.”

If the Office has published a notice of intent to audit a particular Statement of Account in the *Federal Register*, the Office would not accept another notice of intent to audit that Statement. Once the auditor has begun to audit a particular satellite carrier, a particular cable system, or a particular MSO, copyright owners would not be permitted to conduct another audit of that licensee until the following calendar year.

For example, if the auditor started to review a licensee’s Statement of Account for the 2010/1 accounting period on August 1, 2013 and if the auditor delivered his or her final report to the copyright owners by December 31, 2013, the copyright owners would be allowed to audit other Statements filed by that licensee beginning on January 1, 2014. However, if the auditor delivered his or her final report on March 1, 2014, the licensee would not be subject to any other audits in calendar year 2013 or 2014.

The copyright owners could lay the initial groundwork for other audits involving this licensee at any time. For example, the copyright owners could file a notice of intent to audit the licensee’s Statement of Account for the 2011/2 accounting period on October 1, 2013, even if the auditor was still reviewing the licensee’s Statement for the 2010/1 accounting period as of that date. Other participating copyright owners would then be required to notify the copyright owner

and the licensee of their intent to audit the 2011/2 Statement within 30 days thereafter.¹⁶

However, the participating copyright owners could not propose a list of qualified and independent auditors to review the 2011/2 Statement until 30 days after the final report concerning the 2010/1 Statement has been delivered to the participating copyright owners and the licensee.

In order to protect the interests of copyright owners, the Revised Proposal provides an exception to these rules. In the event that the auditor discovers an underpayment in his or her review of a satellite carrier or a particular cable system, the copyright owners would be permitted to audit all of the Statements of Account filed by that particular cable system or satellite carrier during the previous six accounting periods (including a cable system that is owned by an MSO). Consistent with the Federal Rule of Civil Procedure, the copyright owners should exclude the Statements of Account listed in the notice of intent to audit when identifying the “previous six” accounting periods that will be included in the expanded audit.¹⁷ *See* Fed. R. Civ. P. 6(a)(1)(A). In addition, if the auditor discovers an underpayment in his or her review of an MSO, the copyright owners would be permitted to audit a larger sample of the cable systems owned by that operator. Specifically, the copyright owners would be permitted to audit 30 percent of the Form 2 and 30 percent of the Form 3 systems owned by that operator.

Generally speaking, the expanded audit would be considered an extension of the initial audit. However, the copyright owners would be required to file another notice of intent to audit with the Copyright Office, given that the expanded audit would include Statements of Account

¹⁶ As the Office explained in its Notice of Proposed Rulemaking, “if a copyright owner filed a notice of intent to audit a particular Statement of Account or a particular statutory licensee in calendar year 2013 and if that audit was still ongoing as of January 1, 2014, the Office would accept a notice of intent to audit filed in calendar year [2013 or] 2014 concerning other Statements filed by that same licensee.” *See* 77 FR 35645 n.3, June 14, 2012,.

¹⁷ Copyright owners may have an incentive to audit the licensee’s two most recent Statements of Account before auditing the licensee’s earlier Statements, given that an underpayment in the most recent Statements would give the copyright owners an opportunity to audit all of the Statements that the licensee submitted for the previous six accounting periods.

and/or cable systems not listed in the initial notice. Doing so would give other copyright owners an opportunity to join in the expanded audit and it would put them on notice that a subsequent audit of the Statements identified in the notice will not be permitted. In addition, it would provide the statutory licensee with advance notice of the Statements of Account and/or cable systems that would be included within the expanded audit.¹⁸

The Revised Proposal explains that the expanded audit may be conducted by the same auditor who conducted the initial audit, provided that the copyright owners supply the licensee with information sufficient to show that there has been no material change in the auditor's independence and qualifications.¹⁹ If the copyright owners prefer to use a different auditor or if the previous auditor is no longer qualified or independent within the meaning of the regulation, a new auditor may be selected using the procedure discussed in section V(B) above.

Because an expanded audit would be an extension of the initial audit, the copyright owners could proceed with an audit of a satellite carrier or a particular cable system at any time (including a cable operator that is owned by an MSO). For example, if the copyright owners audited a cable operator's Statement for the 2013/1 accounting period in June 2014 and if the auditor discovered an underpayment on that Statement, the copyright owners would be permitted to audit any or all of the operator's Statements for the 2010/1 through 2012/2 accounting periods in calendar year 2014.²⁰ If the auditor delivered his or her final report to the copyright owners by December 31, 2014, the copyright owners would be allowed to audit other Statements filed by

¹⁸ The Office did not adopt the Joint Stakeholders' Proposal, which stated that the expanded audit could be conducted "immediately" without specifying a precise procedure for when and how the expanded audit would begin.

¹⁹ Under the Joint Stakeholders' Proposal, the copyright owners would be allowed to use the same auditor in another audit involving an MSO, but they would not be allowed to use the same auditor two years in a row. The Office fails to see the justification for this limitation.

²⁰ As discussed in section VII(B), the licensee would be required to retain any records needed to confirm the correctness of the calculations and royalty payments reported in these Statements for at least three years after the last day of the year in which the Statement were filed with the Office. Once the licensee has received a notice of intent to audit those Statements, the licensee would be required to retain its records for three years after the auditor delivers his or her final report.

that operator beginning on January 1, 2015. However, if the auditor delivered his or her report on the 2013/1 Statement on or after January 1, 2015, then the operator would not be subject to any other audits in calendar year 2015.

In order to protect the interests of MSOs, the Revised Proposal provides a limited exception to this rule. As discussed above, the copyright owners would be allowed to audit a larger sample of the cable systems owned by an MSO if the auditor discovered an underpayment during the initial audit. However, the expanded audit could not be conducted until the following calendar year. For example, if the auditor discovered an underpayment in the 2013/1 and 2013/2 Statements of Account for one of the Form 2 and four of the Form 3 systems owned by an MSO, the copyright owners would be permitted to audit any or all of the Statements filed by those systems for the 2010/1 through 2012/2 accounting periods. If the auditor delivered his or her report to the copyright owners on July 1, 2014, the copyright owners could proceed with this expanded audit in calendar year 2014. In addition, the copyright owners would be allowed to audit the Statements filed by 30 percent of the Form 2 and 30 percent of the Form 3 systems owned by that operator. However, those systems could not be audited until January 1, 2015, and the copyright owners would not be allowed to audit any other cable systems owned by that MSO in calendar year 2015.

In all cases, the copyright owners would only be allowed to conduct an expanded audit if the auditor discovers a “net aggregate underpayment” of 5 percent or more on all of the Statements listed in the notice of intent to audit.²¹ This addresses AT&T’s concern that the

²¹ The Revised Proposal differs from the Joint Stakeholders’ Proposal by clarifying that the copyright owners would be allowed to conduct an expanded audit if the auditor discovers an underpayment that is 5 percent or more of the amount reported on the Statements of Account at issue in the audit, as opposed to requiring a net aggregate underpayment of exactly 5 percent. In making this calculation the auditor would be required to subtract the total amount of any overpayments reflected on the Statements at issue in the audit from any underpayments reflected on those Statements.

underpayment should exceed a minimum percentage in order to trigger an expanded audit, and the NCTA's concern that an isolated underpayment in a single Statement of Account should not trigger an audit of all of the systems owned by an MSO.

The Office assumes that the amount of underpayments and overpayments that may be discovered in an audit may vary depending on the size of the statutory licensee and the amount of its royalty obligations. Therefore, the Office is not inclined to set a minimum monetary threshold needed to trigger an expanded audit (as AT&T recommended). Nor is the Office inclined to create a separate procedure for resolving disagreements over legal, regulatory, or accounting issues before an audit is expanded (as AT&T suggested). The Office believes that the consultation between the auditor and the statutory licensee, and the opportunity to prepare a written response to the auditor's conclusions should provide the parties with an adequate opportunity to air their differences concerning the auditor's conclusions.

IX. Disputing the Facts and Conclusions Set Forth in the Auditor's Report

A. Comments

The Notice of Proposed Rulemaking proposed that the auditor prepare a written report setting forth his or her conclusions and deliver a copy of that report to the statutory licensee before it is delivered to any of the copyright owner(s) that elected to participate in the audit. If the statutory licensee disagrees with any of the facts or conclusions set forth in the auditor's report, the licensee's designee should raise those issues during the initial consultation with the auditor. If the auditor agrees that a mistake has been made, the auditor should correct those errors before the final report is delivered to the copyright owners. If the facts or conclusions set forth in the auditor's report remain in dispute after the consultation period has ended, the licensee would have the opportunity to provide the auditor with a written response setting forth its views

within two weeks (*e.g.*, 14 calendar days) after the date of the initial consultation between the auditor and the licensee's representative. The auditor would be required to include that response as an attachment to his or her final report, which would have to be delivered to the copyright owners and the statutory licensee within 60 days after the date that the auditor delivered the initial draft of his or her report to the licensee.²²

The Office invited comment on whether the regulation should provide a precise amount of time for the auditor to discuss his or her report with the statutory licensee's designee, and if so, whether 30 days would be a sufficient amount of time. AT&T stated that the licensee should be given 45 days to review the initial report before the consultation period begins; none of the other parties commented on this aspect of the proposal.

The Office also invited comment on whether 14 days would be a sufficient amount of time for the statutory licensee to prepare a written response to the auditor's report, and whether 60 days would be a sufficient amount of time for the auditor to prepare his or her final report for the copyright owners. ACA stated that a 14 day deadline would "increase administrative burdens" for smaller cable operators, and that they should be given "flexibility to respond within a reasonable amount of time." (ACA at 8.) AT&T agreed that 14 days would be "wholly inadequate" and that a statutory licensee should be given 60 days to prepare a written response to the auditor's report. AT&T also contended that a licensee should be allowed to extend the response period for another 30 days if the 60-day period falls within 75 days before the due date for submitting a semiannual Statement of Account. (AT&T at 9-10.) The NCTA expressed the same view, stating that the 14 day deadline for preparing a written response to the auditor and the 60 day deadline for completing the final report would be "unreasonably short." (NCTA at 9.)

²² The Copyright Owners said that the Office should provide "a hard deadline for issuing the final report" (Copyright Owners at 9), but in fact, the deadline that they recommended in their comments is precisely the same as the deadline specified in the Notice of Proposed Rulemaking.

B. Discussion

The Notice of Proposed Rulemaking and the Revised Proposal follow the same approach for disputing the facts and conclusions set forth in the auditor's report. The only difference is that the Revised Proposal would require the auditor to deliver his or her final report to the copyright owners within 5 business days after the statutory licensee's deadline for delivering its written response to that report.

AT&T stated that the statutory licensee should be given 45 days to review the initial draft of the auditor's report before the consultation period begins, and AT&T, the ACA, and the NCTA predicted that cable operators would need more than 14 days to prepare a written response to that report. However, none of the parties offered any evidence to support these claims, and the Office continues to believe that 44 days (*i.e.*, 30 days for the consultation period plus another 14 days to prepare a written response) is a reasonable amount of time for the licensee to review and respond to the auditor's report.

Under the Joint Stakeholders' proposal, the auditor would be required to send his or her report to both the participating copyright owners and the licensee even if the auditor has reason to suspect that the licensee has committed fraud and that disclosing his or her conclusions to the licensee would prejudice further investigation of that fraud. The Office is concerned that sending the report to both parties may defeat the purpose of withholding the auditor's suspicions from the licensee. Therefore, the Revised Proposal states that the auditor may send a copy of his or her report to the copyright owners in this situation without providing a complete copy to the licensee. However, the Office is also concerned that the licensee would be denied the opportunity to consult with the auditor and to remedy any errors or disputed facts or conclusions set forth in the auditor's report, as required by section 111(6)(C) of the Act. Therefore, the

Revised Proposal would allow the auditor to deliver an abridged version of the report to the licensee that contains all of the facts and conclusions set forth in his or her report to the copyright owners except for the auditor's ultimate conclusion that the licensee has committed fraud.

The Revised Proposal also differs from the Joint Stakeholder' proposal for suspending the audit in the period prior to the deadline for filing semiannual Statements of Account. As discussed above, the Revised Proposal would allow the licensee to suspend the audit for up to 30 days before the deadline for filing its semiannual Statement of Account, but the licensee would not be allowed to exercise this option once the auditor has delivered the initial draft of his or her report to the licensee. DISH predicted that a licensee may need to devote "certain resources" in order to respond to the auditor's "inquiries" (DISH at 6), but neither DISH nor any other party offered any evidence to suggest that the time needed to consult with the auditor or to prepare a written response to the auditor's report would prevent a licensee from filing its semiannual Statement of Account in a timely manner. Nor is the Office aware of such problems in the audit procedures for statements of account filed under the section 112 and 114 licenses or under chapter 10.

X. Correcting Errors and Curing Underpayments Identified in the Auditor's Report

A. Comments

The Notice of Proposed Rulemaking explained that if the auditor concludes that the information in a Statement of Account is incorrect or incomplete, that the calculation of the royalty fee was incorrect, or that the statutory licensee failed to deposit the royalties owed with the Office, the licensee may correct those errors by filing an amended Statement of Account and/or by submitting supplemental royalty payments to the Office. To do so, the licensee should follow the procedures set forth in 37 CFR 201.11(h)(1) and 201.17(m)(3), including the

obligation to pay interest on any underpayment that may be due and the requisite amendment fee. The Office invited comment on whether statutory licensees should be given a deadline for correcting errors in their Statements of Account and for making supplemental royalty payments, and if so, whether 30 days would be a sufficient amount of time.

The Copyright Owners contended that if an independent auditor determines that a statutory licensee failed to pay the correct amount of royalties, the licensee should be required to file an amended Statement of Account and to correct the underpayment within 30 days after the auditor delivers his or her final report. Otherwise, the licensee would have a “perverse incentive” to ignore the auditor’s conclusions “until either the statute of limitation runs or a copyright owner drafts an infringement complaint.” (Copyright Owners at 8-9.) In the NCTA’s view, the statutory license should be allowed to amend its Statement of Account and to make any supplemental royalty payments after the consultation period has ended but before the auditor has delivered his or her final report to the copyright owners. (NCTA at 10.) AT&T contended that the licensee should be given an opportunity to cure any alleged underpayments within 60 days after the consultation period has ended. In addition, AT&T said that “[t]he regulation should make clear that such remediation and cure does not constitute [the] licensee’s admission that the prior reports and payments were wrong.” (AT&T at 9-10.)

While the Notice of Proposed Rulemaking gave statutory licensees an opportunity to correct any underpayments in their Statements of Account at any time, it did not allow licensees to request a refund from the Office in the event that the auditor discovered an overpayment. In DTV’s view, a licensee should be allowed to request a refund in this situation, or in the alternative, to deduct the overpayment from a future Statement of Account. (DTV at 2-3.) The

NCTA agreed that cable operators should be allowed to request refunds for any overpayments discovered during the course of an audit. (NCTA at 14-15.)

B. Discussion

Generally speaking, the Notice of Proposed Rulemaking and the Revised Proposal give the statutory licensee the opportunity to correct any errors or underpayments reported in a Statement of Account. The primary difference is that the Revised Proposal would give the licensee a precise deadline for exercising this option. It states that the licensee may file an amended Statement of Account and may submit supplemental royalty fees within 60 days after the auditor delivers his or her final report to the copyright owners and the statutory licensee or within 90 days after that date in the case of an audit involving an MSO. In addition, the Revised Proposal would allow the licensee to request a refund from the Office if the auditor discovered an overpayment on any of the Statements of Account at issue in the audit.

The Office will issue a refund under its current regulations if a request to amend a Statement of Account is received within 30 to 60 days after the last day of the accounting period for that Statement or within 30 to 60 days after the overpayment was received in the Office,²³ whichever is longer, or if the Office discovers a legitimate overpayment in its examination of an initial Statement or amended Statement. *See* 37 CFR 201.11(h)(1); 201.11(h)(3)(i)-(vi); 201.17(m)(3)(i)-(vi). STELA directed the Office to establish a mechanism for correcting “any underpayment identified” in the auditor’s report, but it did not mention overpayments or refunds. *See* section 111(d)(6)(C)(ii). Nevertheless, the Office does have the authority to prescribe regulations concerning the Statements of Account that cable operators and satellite carriers file with the Office, 17 U.S.C. 111(d)(1); 119(b)(1), and the Office agrees that a regulation authorizing refunds for overpayments discovered in the course of a verification procedure would

²³ The deadline for satellite carriers is 30 days, while the deadline for cable operators is 60 days.

be consistent with “the administration of the functions and duties made the responsibility of the Register” under title 17 of the U.S. Code. 17 U.S.C. 702.

Under the Revised Proposal the statutory licensee may request a refund for an overpayment that is discovered during an audit by following the procedures set forth in §§ 201.17(m)(3) or 201.11(h)(3) of the regulations. The refund request must be received in the Office within 30 days after the auditor has delivered his or her final report to the licensee. The Joint Stakeholders’ proposal would have given the licensee 60 days to request a refund, but the Office concluded that 30 days would be more appropriate, given that the amount of the overpayment and the basis for the refund request would be apparent from the auditor’s report.

When the Office receives a notice of intent to audit a particular Statement of Account and until the conclusion of that audit, the Office will retain sufficient royalties to ensure that funds are available in the event that the licensee subsequently requests a refund. The Office does not need a copy of the auditor’s final report, but it would be helpful to know when the audit has been completed. Therefore, the Revised Proposal directs a representative of the participating copyright owners to notify the Office when the auditor has delivered his or her final report and to state whether the auditor discovered an overpayment on any of the Statements at issue in the audit. If the auditor did not discover any overpayments, the royalties will be made available for distribution to the copyright owners at the appropriate time.

XI. Cost of the Audit Procedure

A. Comments

The Notice of Proposed Rulemaking explained that the copyright owner(s) who selected the auditor would be expected to pay the auditor for his or her work in connection with the audit, unless the auditor were to determine that there was an underpayment of 5 percent or more

reported in any Statement of Account that is subject to the audit. If so, the statutory licensee would be expected to pay the auditor's fee. If the auditor's determination is subsequently rejected by a court, then the copyright owners would have to reimburse the statutory licensee for the cost of the auditor's services. The Office invited comment on whether the regulation should include a cost-shifting provision, and if so, whether the percentage of underpayment needed to trigger this provision should be more or less than 5 percent. *See* 77 FR 35649, June 14, 2012.

This proved to be the most controversial aspect of the proposed regulation. The Copyright Owners supported the proposal, noting that it would be consistent with the verification procedures that the Office has issued for other statutory licensees. (Copyright Owners at 9-10.) AT&T, DISH, ACA, and the NCTA strongly opposed the idea.²⁴

AT&T contended that the Office does not have the legal authority to shift the costs of the audit from the copyright owners to the statutory licensee. AT&T stated that “the absence of any provision relating to cost-shifting . . . confirms that Congress did not intend for the Register to authorize cost-shifting,” and the fact that the statute indicates “that the auditor is working on behalf of copyright owners” suggests that the cost of the audit should be paid by the copyright owners. (AT&T at 5-6.) AT&T also suggested that the cost-shifting provision “would implicate due process and delegation concerns,” because it “effectively grants an interested private party the authority to regulate ‘private persons whose interests may be and often are adverse.’” AT&T contended that this represents “an intolerable and unconstitutional interference with personal liberty and private property,” that it is “clearly arbitrary,” and that it constitutes “a denial of rights safeguarded by the due process clause of the Fifth Amendment.” (AT&T at 7, quoting *Carter v. Coal Co.*, 298 U.S. 238 (1936)).

²⁴ DTV took no position on this issue.

AT&T, the ACA, the NCTA, and DISH contended that cost-shifting would be unfair to the statutory licensee. They predicted that statutory licensees would expend substantial resources in responding to the audit, they noted that licensees would not be able to recover any of their costs from the copyright owners, nor would licensees receive any financial benefit from the verification procedure that might offset these costs. By contrast, the copyright owners could decline to participate in the audit if they do not wish to pay for the auditor's services, and if they decide to join the audit they could split the cost of the audit amongst themselves. (ACA at 3; DISH at 9; NCTA at 13.)

ACA worried that a 5 percent underpayment threshold could result in a relatively small underpayment giving rise "to an audit bill several orders of magnitude larger." (ACA at 1, 3.) AT&T and DISH predicted that this would encourage the auditor to look for "discrepancies even where they do not exist" and "to raise as many issues as possible, whatever their merit." (AT&T at 6; DISH at 9.) AT&T also predicted that a cost-shifting provision would discourage licensees from correcting the underpayments reported on their Statements of Account, because a supplementary payment could be viewed as an admission that the auditor's calculations are correct. (AT&T at 6.) In order to avoid this result, AT&T urged the Office to create a separate "process for resolving disputes or for determining how much a system operator has underpaid." (AT&T at 7.)

Although they strongly opposed the Office's cost-shifting proposal, the ACA, the NCTA, and AT&T offered several suggestions for improving the cost-shifting provision. ACA stated that the underpayment threshold should be set significantly higher than 5 percent, that the underpayment should surpass a minimum dollar amount in order to trigger a cost-shifting, and that the Office should provide additional relief for small cable operators. (ACA at 1, 3, 4.)

AT&T and the NCTA expressed a similar view. AT&T stated that the cost of the audit should only be shifted if the auditor discovers an underpayment of \$10,000 or more. (AT&T at 7-8.) In addition, AT&T and the NCTA agreed that the cost of the audit should only be shifted if the auditor finds an underpayment of 10 percent or more, noting that a 10 percent threshold would be consistent with the trigger that the Office has adopted in its other audit regulations. (AT&T at 7-8; AT&T Reply at 3; NCTA at 13.)

In determining whether the minimum threshold has been met, both AT&T and the NCTA said that the auditor should consider the total amount of royalties reported by all of the cable systems and reflected on all of the Statements of Account that are at issue in the audit. The NCTA stated that the auditor should consider both overpayments and underpayments in making this calculation. However, AT&T stated that the auditor should not consider “underpayments attributable to reasonable disagreements on issues of law, constructions of regulations, or accounting procedures” or other issues “about which reasonable minds may differ.” (AT&T at 7-8; NCTA at 13.)

Both AT&T and the NCTA stated that the costs of the audit must be reasonable, and that in no event, should the licensee be required to pay for costs that exceed the amount of the underpayment. (AT&T Reply at 3; NCTA at 13, 14.) They stated that the statutory licensee should not be required to pay for an audit unless a court determines that the licensee failed to report the correct amount of royalties, noting that requiring a final judicial determination would be consistent with the cost-shifting procedures set forth in the Office’s other audit regulations. (AT&T at 7-8; AT&T Reply at 3; NCTA at 14.) In addition, AT&T stated that if the auditor discovers an overpayment of 10 percent or more, the copyright owners should be required to reimburse the licensee for the costs that it incurred in responding to the audit. AT&T contended

that this would discourage copyright owners from abusing the verification procedure. (AT&T at 7-8.)

As discussed above, the Notice of Proposed Rulemaking would allow copyright owners to expand the scope of the audit to include other systems owned by an MSO if the auditor discovers an underpayment in an audit of its systems. (AT&T at 7.) AT&T stated that the statutory licensee should not be required to pay for the cost of an expanded audit based solely on the fact that the auditor discovered an underpayment in the initial audit. (AT&T at 8.)

B. Discussion

1. The Office Has the Authority to Include a Cost-Shifting Provision in Its Audit Regulations

Section 702 of the Act states that “The Register of Copyrights is authorized to establish regulations not inconsistent with law for the administration of the functions and duties made the responsibility of the Register under this title.” 17 U.S.C. 702. This includes the authority to prescribe regulations concerning the Statements of Account that cable operators and satellite carriers file with the Office, and the authority to prescribe regulations concerning the verification of those Statements. *See* 17 U.S.C. 111(d)(1); 111(d)(6); 119(b)(1), 119(b)(2). The Office has concluded that a regulation authorizing cost-shifting for underpayments discovered in the course of a verification procedure would be consistent with “the administration of the functions and duties made the responsibility of the Register” under title 17 of the U.S. Code. 17 U.S.C. 702. Moreover, the Office is not aware of any provision in sections 111(d)(6), 119(b)(2), or elsewhere in the Act that precludes the Office from adopting regulations that allocate the cost of a verification procedure among the participants.

While there is no legislative history for STELA, the legislative history for a prior iteration of the legislation lends some additional support for the Office’s conclusion.²⁵ Sections 102(f)(4) and 104(c)(6) of the earlier bill directed the Register to issue regulations to allow copyright owners to verify the Statements of Account and royalty fees that cable operators and satellite carriers deposit with the Office. Like sections 111(d)(6) and 119(b)(2) of the current statute, the earlier bill did not indicate whether the regulations should include a cost-shifting provision or whether those costs should be paid by the copyright owners or by the statutory licensee, or both. *See* Satellite Home Viewer Reauthorization Act of 2009, H.R. 3570, 111th Cong. §§ 102(f)(4), 104(c)(6) (2009).²⁶ However, the House Report for the earlier bill stated that “[t]he rules adopted by the Office shall include procedures allocating responsibility for the cost of audits consistent with such procedures in other audit provisions in its rules.” *See* H.R. Rep. No. 111-319, at 10 (2009).

The House was aware that the Office has established verification procedures in the past and that the Office has included a cost-shifting provision in those regulations.²⁷ The fact that the House directed the Office to “include procedures allocating responsibility for the costs of audits” – despite the fact that the earlier bill did not explicitly mention this issue – indicates that the House expected the Office to include a cost-shifting provision in this regulation consistent with its long-standing practice of allocating costs among stakeholders on a reasonable basis. While

²⁵ *See Defense Logistics Agency v. Federal Labor Relations Authority*, 754 F.2d 1003, 1008 (D.C. Cir. 1985) (noting that a House Committee report on an earlier version of a statutory provision provided “some support” for the agency’s interpretation of the provision which was subsequently enacted by Congress); *Crooker v. Bureau of Alcohol, Tobacco & Firearms*, 670 F.2d 1051, 1074 n.59 (D.C. Cir. 1981) (noting that “[t]o the extent that the legislative history of earlier bills is useful,” it tended to support the court’s interpretation of the legislation that Congress subsequently enacted).

²⁶ The bill was passed by the House on December 3, 2009. The bill was read twice in the Senate and referred to the Committee on the Judiciary.

²⁷ As the Office stated in the Notice of Proposed Rulemaking, the Office included a cost-shifting provision in its regulations concerning the audit of Statements of Account and royalty payments made under section 112, section 114, and chapter 10. *See* 77 FR 35649, June 14, 2012.

the House Report tends to support the conclusion that the Office has the authority to create a cost-shifting procedure, the Office recognizes that the value of the House Committee's remarks is limited, given that Congress made significant changes to the provision concerning the verification procedure for cable operators before it was enacted in STELA (although the provision concerning the verification procedure for satellite carriers remained unchanged).²⁸

AT&T contended that the cost-shifting provision would be unconstitutional, because it would impose "costs on the system operator based on the judgment of a private party" and it would allow the auditor to be "prosecutor, judge, and jury" if there is a dispute concerning the auditor's calculations.²⁹ (AT&T at 7.) AT&T did not contend that it would be a violation of due process or the delegation doctrine to allow an auditor to verify the information provided in a Statement of Account or to use the auditor's determination as the appropriate baseline for curing underpayments, requesting refunds, or expanding the scope of the audit to include other Statements filed by the statutory licensee. Nor does AT&T explain why the cost-shifting provision would be unconstitutional, while these other aspects of the regulation would not.

In any event, the cost-shifting provision is not a violation of due process, because *inter alia*, the statutory licensee would be given an opportunity to meet and confer with the auditor report, to identify errors or mistakes in the initial draft of the auditor's report, and to prepare a written response to the auditor's conclusions before he or she delivers the final report to the

²⁸ See *Defense Logistics Agency*, 754 F.2d at 1008 (explaining that it would be "unwise to place great weight" on the legislative history for a prior version of a bill where the legislation "was altered significantly before adoption").

²⁹ In support of this argument AT&T cited two cases from the Great Depression, which are clearly distinguishable. In *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935) the Supreme Court held the National Industrial Recovery Act of 1933 to be unconstitutional, because it allowed poultry producers – rather than the government – to establish "codes of fair competition" for the poultry industry. Likewise, in *Carter v. Coal Co.*, 298 U.S. 238 (1936), the Court held the Bituminous Coal Conservation Act of 1935 to be unconstitutional, because it stated that if the companies that produce more than two-thirds of the nation's annual production of coal negotiated a labor agreement with more than half of their workers, then the minimum wages and maximum work hours specified in those contracts would be binding upon other coal mining companies. Unlike the laws at issue in these cases, STELA authorizes an auditor to confirm the correctness of the calculations and royalty payments reported on a particular Statement of Account, but the auditor's determination would not be binding upon any other statutory licensee or any other Statements that are not included within that audit.

copyright owners. If the licensee disagrees with the auditor's conclusion, the licensee could ask a court of competent jurisdiction to review that decision, and if the court agrees that the underpayment did not meet the threshold set forth in the proposed regulation, the copyright owners would be required to reimburse the licensee for the amount that it contributed to the cost of the audit. Likewise, the proposed regulation is not a violation of the delegation doctrine, because STELA expressly directs the Office – not the private industry – to develop a procedure for the verification of Statements of Account and royalty payments (although the Office has received valuable input on the proposed regulation from the Joint Stakeholders and other interested parties). *See Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 398 (1940) (“Since law-making is not entrusted to the industry, this statutory scheme is unquestionably valid.”).

AT&T, the ACA, and DISH predicted that the proposed regulation would be unduly burdensome for the statutory licensee. The Office weighed these concerns, but believes that they have been adequately addressed in the Revised Proposal. The Office also notes that cost-shifting provisions are commonly used in private agreements that provide a contractual right to audit another party's books or records, and the Office assumes that agreements negotiated by members of the copyright, cable, and satellite industries are no exception.

AT&T, the ACA, and DISH contended that statutory licensees should not be required to pay for the costs of an audit, because they would incur significant costs in responding to an audit. They also contended that licensees would not be able to recover any of their costs from the copyright owners (even if the auditor discovered an overpayment), nor would they receive any financial benefit from the verification procedure that could be used to offset their costs.

The cable and satellite industries receive a substantial benefit from the statutory licensing system, insofar as it provides a mechanism for licensing the public performance and display of broadcast content without having to negotiate with the owners of that content. Moreover, the Congressional Budget Office estimated that the cost of responding to an audit “would be minimal,” because the auditor would be verifying information that “is already collected and maintained by satellite and cable carriers” as a condition for using the statutory license. *See* H.R. Rep. No. 111-319, at 20 (2009). While the cost of complying with the verification procedure may be a new obligation, this is simply a cost of doing business under the statutory licensing system, much like the obligation to pay royalties and the recordkeeping and reporting requirements.

2. The Revised Proposal

AT&T, the ACA, and the NCTA offered several suggestions for improving the cost-shifting procedure, and most of those suggestions have been included in the Revised Proposal. If the auditor discovers a net aggregate underpayment³⁰ of more than 10 percent on the Statements of Account at issue in the audit, then the statutory licensee would be required to reimburse the copyright owners for the cost of the audit. If the licensee prepared a written response to the auditor’s report and if the methodology set forth in that response indicates that there was a net aggregate underpayment between 5 percent and 10 percent of the amount reported on the Statements of Account, then the cost of the audit would be split evenly between the copyright owners and the licensee. However, if the net aggregate underpayment is less than 5 percent or if the auditor discovers an overpayment rather than an underpayment, then the participating copyright owner(s) would be required to pay for the auditor’s services.

³⁰ This term is defined and discussed in section VIII(B) above.

The Office did not adopt the methodology proposed by the Joint Stakeholders, because it may impose an unfair burden on small cable operators. Specifically, the Joint Stakeholders would require the licensee to pay for half the cost of the audit if the auditor discovered a net aggregate underpayment of 10 percent or less – even if the underpayment was as low as .001 percent of the amount reported on the Statements of Account. In other words, the licensee could potentially be required to pay a portion of the auditor’s costs whenever there is an underpayment, regardless of the amount of that underpayment.

In determining whether the minimum threshold has been met, the auditor would consider the total amount of royalties reported on all of the Statements at issue in the audit, including any overpayments or underpayments. This addresses the ACA’s and the NCTA’s concern that audit costs might be shifted to the statutory licensee based on a minor discrepancy on a single Statement of Account. If the auditor discovers a net aggregate underpayment in an audit of an MSO, then as discussed above, the copyright owners would be allowed to expand the scope of the audit to include other Statements filed by the systems at issue in that audit and/or other systems owned by that MSO. Although the expanded audit would be considered an extension of the initial audit, the licensee would not be required to pay for the cost of the expanded audit unless the auditor discovered a net aggregate underpayment on the Statements at issue in the expanded audit (even if the same auditor conducted both the initial audit and the expanded audit).

Consistent with AT&T’s and the NCTA’s recommendation, the statutory licensee would not be required to pay for any portion of the auditor’s costs that exceed the amount of the net aggregate underpayment reported on its Statements of Account. This would appear to address the ACA’s request for special relief for small cable operators (although the cap on audit costs would apply to large and small statutory licensees alike). For example, if the auditor discovered

net aggregate underpayment of \$3,000 and if that amount was more than 10 percent of the amount reported on all of the Statements of Account at issue in the audit, then the licensee would be given an opportunity to amend its Statements of Account and to deposit \$3,000 (plus any applicable interest on that amount) with the Office to cover the deficiency in its initial filings. If the auditor charged \$2,500 for his or her work on the audit, the licensee would be required to pay another \$2,500 to a representative of the participating copyright owners to cover the cost of the audit. However, if the auditor charged \$3,300 for his or her services, then licensee would be required to pay the copyright owners no more than \$3,000 for the cost of the audit, and the participating copyright owners would be expected to pay the auditor \$300 to cover the remaining amount.

The Office is not inclined to create a separate procedure for resolving disagreements over legal, regulatory, or accounting issues before the cost-shifting provision would be triggered (as AT&T suggested). The Revised Proposal already protects statutory licensees by giving them an opportunity to meet and confer with the auditor, to identify errors or discrepancies in the initial draft of the auditor's report, and to prepare a written response to the auditor's conclusions before the auditor delivers his or her final report to the copyright owners. At the same time, it protects the interests of the copyright owners by giving the statutory licensee a precise deadline for reimbursing the participating copyright owners for the licensee's share of the audit costs.

The Joint Stakeholders' proposal would require the auditor to provide the participating copyright owners and the licensee with an itemized statement by the 15th of each month specifying the costs incurred by the auditor in the preceding month. The Office agrees that the participating copyright owners should provide the licensee with an itemized statement at the conclusion of the audit specifying the total costs incurred by the auditor. However, requiring the

auditor to provide monthly statements could be used as an excuse for harassing the auditor and interfering with his or her conduct of the audit. The participating copyright owners could agree to provide the licensee with copies of the auditor's billing statements in the auditor's engagement letter or in a side agreement with the licensee, but the Office is not inclined to require this type of micro-management in the regulation.

As discussed above, the amount of underpayments and overpayments that may be discovered in an audit may vary depending on the size of the statutory licensee, the amount of its royalty obligations, and the accuracy of its accounting procedures. Therefore, the Office is not inclined to specify a minimum dollar amount that would be needed to shift costs from the copyright owners to the statutory licensee (as AT&T and the ACA suggested).

AT&T and DISH worried that the cost-shifting provision would encourage the auditor to look for discrepancies even where they do not exist. This does not appear to be a valid concern, because the auditor would not be entitled to collect a contingency fee based on the results of the audit. Instead, the auditor would be paid a flat fee or an hourly rate regardless of whether he or she discovers an underpayment or an overpayment on the Statements of Account. Moreover, the requirement that the auditor be a qualified and an independent certified public accountant subject to the Code of Professional Conduct of the American Institute of Certified Public Accountants should diminish significantly any concerns that the auditor would perform unnecessary procedures beyond those needed to conduct an accurate and thorough audit.

AT&T contended that the copyright owners should be required to reimburse the licensee for the costs that it incurred in responding to the audit if the auditor discovers an overpayment on a Statement of Account. The Office is not inclined to accept this proposal, because as discussed above, the Congressional Budget Office has estimated that the cost of responding to an audit

request would be minimal. Moreover, the Revised Proposal contains a number of provisions that should deter copyright owners from abusing the verification procedure, such as the limit on the number of audits that may be conducted per year, the limit on the topics that the auditor may review, and the fact that the copyright owners would be required to pay for the entire cost of the audit if the auditor discovers that the licensee overpaid rather than underpaid.

AT&T also predicted that the cost-shifting provision would discourage the licensee from curing its underpayment, because making a supplemental payment could be viewed as a concession that the licensee failed to report the correct amount on its Statement of Account. That is a *non sequitur*. The Revised Proposal states that if the auditor discovers an underpayment on a Statement of Account, the licensee “may” cure that underpayment by submitting additional royalty payments, although the licensee is not required to do so.³¹ Thus, the fact that the licensee may be required to reimburse the copyright owners for the cost of the audit would not appear to be an admission of liability, particularly if the licensee prepares a written response expressing its disagreement with the auditor’s conclusions and declines to amend its Statement of Account or submit any supplemental payments within the time allowed.

Finally, AT&T stated that the licensee should not be required to pay for the cost of the audit unless a court determines that the licensee failed to report the correct amount on its Statement of Account.³² The Office believes that the Revised Proposal strikes a more appropriate balance between the interests of the participating copyright owners and the statutory licensees. If the auditor determines that the licensee failed to pay and report the correct amount

³¹ Both the Notice of Proposed Rulemaking and the Joint Stakeholders’ proposal took this same approach.

³² The Office’s regulation on digital audio recording devices is the only procedure that specifically requires a “judicial determination” in order to shift costs from the copyright owners to the statutory licensee. *See* 37 CFR 201.30(i). The regulation on ephemeral recordings and the digital transmission of sound recordings states that the cost of the audit should be paid by the licensee if an independent auditor concludes that there was an underpayment of 5 percent or more. *See* 37 CFR. 260.5(f); 260.6(f). The rest of the regulations state that the costs should be shifted if it is “finally determined that there was an underpayment,” without specifying whether the determination should be made by the auditor or in a judicial proceeding. *See* 37 CFR 261.6(g); 261.7(g); 262.6(g); 262.7(g).

on its Statements of Account and if the underpayment was more than 10 percent of the total amount reported on those Statements, then the licensee would be required to pay for the cost of the audit. If the licensee disagrees with that assessment, the licensee could seek a declaratory judgment of non-infringement and an order directing the copyright owners to reimburse the licensee for the cost of the audit. Conversely, if the auditor determines that the licensee failed to pay the correct amount and if the licensee fails to deposit any additional royalties with the Office within the time allowed, the copyright owners could file an infringement action seeking damages and an injunction. In other words, both parties would need to take legal action at the conclusion of the audit if the other party disagrees with the auditor's conclusions, and the prevailing party in that dispute would be reimbursed under the Revised Proposal, regardless of whether the case is filed by the copyright owners or the licensee.

XII. Confidentiality

A. Comments

The Notice of Proposed Rulemaking explained that the auditor should be permitted to review confidential information in the course of the verification procedure, and that the auditor should be permitted to share that information with his or her employees, agents, consultants, and independent contractors, provided that they are not employees, officers, or agents of a copyright owner, and provided that those individuals enter into an appropriate confidentiality agreement governing their use of that material. *See* 77 FR 35650, June 14, 2012.

AT&T and the NCTA contended that these restrictions are insufficient. Specifically, the NCTA stated that if the auditor includes any supporting documentation in his or her final report to the copyright owners, that information should be presented in a separate appendix and it should be redacted to protect any confidential information contained therein. (NCTA at 11-12.)

AT&T contended that the auditor should be required to enter into a confidentiality agreement with the statutory licensee, and that an auditor who breaches his or her obligations under that agreement should be subject to monetary damages and injunctive relief and should be barred from conducting any additional audits for at least three years. AT&T agreed that the copyright owners should not be given access to any confidential information, but it contended that this prohibition should also apply to the copyright owners' affiliates as well as the employees, officers, and agents of any other statutory licensee that retransmits broadcast programming under sections 111 or 119. (AT&T at 10.) The Copyright Owners generally agreed that any party that is owned or controlled by another statutory licensee should not be permitted to review confidential information that may be produced during the course of an audit. (Copyright Owners at 10.)

B. Discussion

The Revised Proposal explains that access to confidential information should be limited to the auditor who conducts the verification procedure and a discrete class of persons who are listed in paragraph (m)(2)(ii) of the regulation. Specifically, the auditor would be allowed to share confidential information with his or her employees, agents, consultants, and independent contractors who need access to the information in order to perform their duties in connection with the audit. In addition, the auditor would be allowed to share confidential information with outside counsel for the participating copyright owners (including any third party consultants retained by outside counsel). Neither the auditor nor the auditor's employees, agents, consultants, and independent contractors could be employees, officers, or agents of a copyright owner for any

purpose other than the audit, and any other person who receives confidential information during the course of an audit would have to implement procedures to safeguard that information.

If the auditor includes any supporting documentation in his or her final report to the copyright owners, the auditor would have to redact any confidential information contained therein, because the auditor is never allowed to share confidential information with the copyright owners. However, the auditor could provide an unredacted copy of the report to outside counsel for the participating copyright owners. Likewise, the auditor would not be allowed to share confidential information with the copyright owners' affiliates or with the employees, officers, and agents of any other statutory licensee, because those parties are not expressly mentioned in the class of persons who may be given access to confidential information under paragraph (m)(2) of the Revised Proposal.

While outside counsel and the auditor's employees, agents, consultants, and independent contractors would be required to enter into an appropriate confidentiality agreement governing the use of the confidential information, the auditor would not be subject to the same requirement (as AT&T suggested). The Office does not believe that this is necessary given that the rules of professional conduct for certified public accountants already prohibit the disclosure of confidential information.

XIII. Conclusion

The Office seeks comment from the public on the subjects discussed above related to the implementation of the audit provisions adopted by Congress with the passage of the Satellite Television Extension and Localism Act of 2010.

List of Subjects

37 CFR Part 201

Copyright, General Provisions.

Proposed Regulation

In consideration of the foregoing, the Copyright Office proposes to amend part 201 of 37 CFR, Chapter II, as follows:

PART 201—GENERAL PROVISIONS [AMENDED]

1. The authority citation for this part reads as follows:

Authority: 17 U.S.C. 702, 17 U.S.C. 111(d)(6), and 17 U.S.C. 119(b)(2).

2. Add § 201.16 to read as follows:

§ 201.16 Verification of a Statement of Account and royalty fee payments for secondary transmissions made by cable systems and satellite carriers.

(a) *General.* This section prescribes general rules pertaining to the verification of a Statement of Account and royalty fees filed with the Copyright Office pursuant to sections 111(d)(1) and 119(b)(1) of title 17 of the United States Code, as amended by Pub. L. 111-175.

(b) *Definitions.*

(1) The term *cable system* has the meaning set forth in § 201.17(b)(2) of this part.

(2) *MSO* means an entity that owns, controls, or operates more than one cable system.

(3) *Copyright owner* means any person or entity that owns the copyright in a work embodied in a secondary transmission made by a statutory licensee that filed a Statement of Account with the Copyright Office for an accounting period beginning on or after January 1, 2010, or a designated agent or representative of such person or entity.

(4) *Generally accepted auditing standards* (GAAS) means the auditing standards promulgated by the American Institute of Certified Public Accountants (AICPA).

(5) *Net aggregate underpayment* means the aggregate amount of underpayments found by the auditor less the aggregate amount of any overpayments found by the auditor, as measured against the total amount of royalties reflected on the Statements of Account examined by the auditor.

(6) *Participating copyright owner* means a copyright owner that has filed a notice of intent to audit a particular Statement of Account pursuant to paragraph (c) of this section and any other copyright owner that has given notice of its intent to participate in such audit pursuant to paragraph (d) of this section.

(7) The term *satellite carrier* has the meaning set forth in section 119(d)(6) of title 17 of the United States Code.

(8) The term *secondary transmission* has the meaning set forth in section 111(f)(2) of title 17 of the United States Code, as amended by Pub. L. 111-175.

(9) *Statement of Account* or *Statement* means a semiannual Statement of Account filed with the Copyright Office under section 111(d)(1) or 119(b)(1) of title 17 of the United States Code, as amended by Pub. L. 111-175, or an amended Statement of Account filed with the Office pursuant to §§ 201.11(h) or 201.17(m) of this part.

(10) *Statutory licensee* or *licensee* means a cable system or satellite carrier that filed a Statement of Account with the Office under section 111(d)(1) or 119(b)(1) of title 17 of the United States Code, as amended by Pub. L. 111-175.

(c) *Notice of intent to audit.* Any copyright owner that intends to audit a Statement of Account for an accounting period beginning on or after January 1, 2010 must notify the Register of Copyrights no later than three years after the last day of the year in which the Statement was filed with the Office. The notice of intent to audit may be filed by a copyright owner or a

designated agent that represents a group or multiple groups of copyright owners. The notice shall identify the statutory licensee that filed the Statement(s) with the Copyright Office, the Statement(s) and accounting period(s) that will be subject to the audit, and the party that filed the notice, including its name, address, telephone number, facsimile number, and email address, if any. In addition, the notice shall include a statement that the party owns, or represents one or more copyright owners who own, a work that was embodied in a secondary transmission made by the statutory licensee during one or more of the accounting period(s) specified in the Statement(s) of Account that will be subject to the audit. The notice of intent to audit shall be served on the statutory licensee on the same day that the notice is filed with the Copyright Office. Within 30 days after the notice has been received in the Office, the Office will publish a notice in the *Federal Register* announcing the receipt of the notice of intent to audit.

(d) *Participation by other copyright owners.* Within 30 days after a notice of intent to audit a Statement of Account is published in the *Federal Register* pursuant to paragraph (c) of this section, any other copyright owner who owns a work that was embodied in a secondary transmission made by that statutory licensee during an accounting period covered by the Statement(s) of Account referenced in the *Federal Register* notice and who wishes to participate in the audit of such Statement(s) must give written notice of such participation to the statutory licensee and to the party that filed the notice of intent to audit. The notice given pursuant to this paragraph may be filed by a copyright owner or a designated agent that represents a group or multiple groups of copyright owners, and it shall include all of the information specified in paragraph (c) of this section.

(e) *Selection of the auditor and communications with auditor during the course of the audit.* (1) The participating copyright owner(s) shall provide to the statutory licensee a list of

three independent and qualified auditors, along with information reasonably sufficient for the statutory licensee to evaluate the proposed auditors' independence and qualifications including:

(i) The auditor's *curriculum vitae* and a list of audits that the auditor has conducted pursuant to section 111(d)(6) or 119(b)(2) of title 17 of the United States Code;

(ii) A list and, subject to any confidentiality or other legal restrictions, a brief description of any other work the auditor has performed for any of the participating copyright owners during the prior two calendar years;

(iii) A list identifying the participating copyright owners for whom the auditor's firm has been engaged during the prior two calendar years; and,

(iv) A copy of the engagement letter that would govern the auditor's performance of the audit and that provides for the auditor to be compensated on a non-contingent flat fee or hourly basis that does not take into account the results of the audit.

(2) The statutory licensee shall select one of the proposed auditors within five business days of receiving the list of auditors from the participating copyright owners. That auditor shall conduct the audit on behalf of all copyright owners who own a work that was embodied in a secondary transmission made by the statutory licensee during the accounting period(s) specified in the Statement(s) of Account identified in the notice of intent to audit.

(3) The auditor shall be qualified and independent as defined in this section. An auditor shall be considered qualified and independent if:

(i) He or she is a certified public accountant and a member in good standing with the AICPA and the licensing authority for the jurisdiction(s) where the auditor is licensed to practice;

(ii) He or she is not, for any purpose other than the audit, an officer, employee, or agent of any participating copyright owner;

(iii) He or she is independent as that term is used in the Code of Professional Conduct of the AICPA, including the Principles, Rules, and Interpretations of such Code applicable generally to attest engagements; and

(iv) He or she is independent as that term is used in the Statements on Auditing Standards promulgated by the Auditing Standards Board of the AICPA and Interpretations thereof issued by the Auditing Standards Division of the AICPA.

(4) Following the selection of the auditor and until the distribution of the auditor's report to the participating copyright owner(s) pursuant to paragraph (h) of this section, there may be no *ex parte* communications regarding the audit between the selected auditor and the participating copyright owner(s) or their representatives provided, however, that the auditor may engage in such *ex parte* communications where either:

(i) The auditor has a reasonable basis to suspect fraud and that participation by the statutory licensee in communications regarding the suspected fraud would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud; or

(ii) The auditor provides the licensee with a reasonable opportunity to participate in communications with the participating copyright owner(s) or their representatives and the licensee declines to do so.

(5) Following the selection of the auditor and until 30 days after the distribution of the auditor's report to the participating copyright owner(s) and the statutory licensee pursuant to paragraph (h) of this section, the participating copyright owners may not propose a list of auditors to conduct an audit involving any other Statement of Account filed by the licensee.

(f) *Scope of the audit.* The auditor shall have exclusive authority to verify all of the information reported on the Statements of Account subject to the audit in order to confirm the

correctness of the calculations and royalty payments reported therein; provided, however, that the auditor shall not determine whether any cable system properly classified any broadcast signal as required by § 201.17(e)(9)(iv) and (v) and (h) of this part or whether a satellite carrier properly determined that any subscriber or group of subscribers is eligible to receive any broadcast signals under section 119(a) of title 17 of the United States Code, as amended by Pub. L. 111-175. The auditor may verify the carriage of the broadcast signals on each Statement of Account after reviewing the certified list of broadcast signals provided by the statutory licensee pursuant to paragraph (g)(1) of this section. The audit shall be performed in accordance with GAAS and with consideration given to minimizing the costs and burdens associated with the audit.

(g) *Obligations of the Statutory Licensee.* (1) Within 30 days of the auditor's selection by the statutory licensee pursuant to paragraph (e)(2) of this section, the licensee shall provide the auditor and a representative of the participating copyright owner(s) with a certified list of all broadcast signals retransmitted pursuant to the statutory license in each community covered by each of the Statements of Account subject to the audit, including the call sign for each broadcast signal and each multicast signal. In the case of an audit involving a cable system or MSO, the list must include the classification of each signal on a community by community basis pursuant to § 201.17(e)(9)(iv) and (v) and (h) of this chapter.

(2) The statutory licensee shall provide the auditor with reasonable access to the licensee's books and records and any other information that, consistent with GAAS, the auditor needs in order to conduct his or her audit, and the statutory licensee shall provide the auditor with any information the auditor reasonably requests promptly after receiving such a request.

(3) The audit will be conducted during regular business hours at a location designated by the statutory licensee. If the auditor and statutory licensee agree, the audit may be conducted in whole or in part by means of electronic communication.

(4) The statutory licensee may suspend the audit within 30 days before the semi-annual due dates for filing Statements of Account by providing prompt written notice to the participating copyright owner(s) and the auditor; provided, however, that audit may be suspended for no more than 30 days, the licensee may not exercise this option if the auditor has delivered his or her report to the statutory licensee pursuant to paragraph (h)(1) of this section, and if the participating copyright owner(s) notify the licensee within 10 days of receiving the notice of suspension of their good faith belief that suspension of the audit could prevent the auditor from delivering his or her final report to the participating copyright owner(s) before the statute of limitations expires on any claims under the Copyright Act related to a Statement of Account covered by that audit, the statutory licensee may not suspend the audit unless it first executes a tolling agreement to extend the statute of limitations by a period of time equal to the period of time during which the audit would be suspended.

(h) *Audit report.* (1) Upon completion of the audit, the auditor shall prepare a written report setting forth his or her findings and conclusions. Prior to delivering the report to any participating copyright owner, the auditor shall deliver a copy of that report to the statutory licensee and consult with a designee of the licensee regarding the findings and conclusions set forth in the report for a period not to exceed 30 days. However, if the auditor has a reasonable basis to suspect fraud and that disclosure would, in the reasonable opinion of the auditor, prejudice investigation of such suspected fraud, the auditor may deliver a copy of the report to

the participating copyright owner(s) and an abridged copy to the licensee that omits the auditor's allegation that the licensee has committed fraud.

(2) If, upon consulting with the licensee, the auditor agrees that there are errors in the report, the auditor shall correct those errors before delivering the report to the participating copyright owner(s). If the statutory licensee disagrees with any of the findings or conclusions set forth in the report, the licensee may provide the auditor with a written explanation of its good faith objections within 14 days after the last day of the consultation period.

(3) Within five business days following the last date on which the statutory licensee may provide the auditor with a written response to the report pursuant to paragraph (h)(2) of this section, and subject to the confidentiality provisions set forth in paragraph (m) of this section, the auditor shall deliver a final report to the participating copyright owner(s) and to the statutory licensee, along with a copy of the statutory licensee's written response (if any). A representative of the participating copyright owners shall promptly notify the Office that the audit has been completed and shall state whether the auditor discovered an overpayment on any of the Statements of Account at issue in the audit.

(i) *Corrections, supplemental payments, and refund.* (1) Where the final auditor's report concludes that any of the information reported on a Statement of Account is incorrect or incomplete, that the calculation of the royalty fee payable for a particular accounting period was incorrect, or that the amount deposited in the Copyright Office for that period was too low, a statutory licensee may, within 60 days of the delivery of the final report to the participating copyright owners and the statutory licensee, or within 90 days of the delivery of such report in the case of an audit of an MSO, cure such incorrect or incomplete information or underpayment

by filing an amendment to the Statement of Account and by depositing supplemental royalty fee payments utilizing the procedures set forth in § 201.11(h) or § 201.17(m) of this chapter.

(2) Notwithstanding §§ 201.17(m)(3)(i) and 201.11(h)(3)(i) of this chapter, where the final report reveals an overpayment by the statutory licensee for a particular Statement of Account, the licensee may request a refund of such overpayments within 30 days of the delivery of the final report to the participating copyright owners and the licensee by utilizing the procedures set forth in § 201.11(h)(3) or § 201.17(m)(3) of this chapter.

(j) *Costs of the audit.* (1) Except as provided in this paragraph, the participating copyright owner(s) shall pay for the full costs of the auditor. If the auditor concludes that there was a net aggregate underpayment of more than 10 percent on the Statements of Account at issue in an audit or an expanded audit, the statutory licensee shall pay the auditor's costs associated with that audit. If the statutory licensee provides the auditor with a written explanation of its good faith objections to the auditor's report pursuant to paragraph (h)(2) of this section and the net aggregate underpayment made by the statutory licensee on the basis of that explanation is not more than 10 percent and not less than 5 percent, the costs of the auditor shall be split evenly between the statutory licensee and the participating copyright owner(s); provided, however, that if a court, in a final judgment (*i.e.*, after all appeals have been exhausted) concludes there was a net aggregate underpayment exceeding 10 percent, the statutory licensee shall, subject to paragraph (j)(3) of this section, reimburse the participating copyright owner(s), within 60 days of that final judgment, for any costs of the auditor that the participating copyright owners have paid.

(2) If a statutory licensee is responsible for any portion of the costs of the auditor, a representative of the participating copyright owner(s) will provide the statutory licensee with an itemized accounting of the auditor's total costs and the statutory licensee shall reimburse such

representative for the appropriate share of those costs within 30 days of the statutory licensee's payment of supplemental royalties (if applicable) or within 90 days of the delivery to the participating copyright owners and the statutory licensee of the final report, whichever is later. Notwithstanding the foregoing, if a court, in a final judgment (*i.e.*, after all appeals have been exhausted) concludes that the statutory licensee's net aggregate underpayment, if any, was 10 percent or less, the participating copyright owner(s) shall reimburse the licensee, within 60 days of the final judgment, for any costs of the auditor that the licensee has paid.

(3) No portion of the auditor's costs that exceed the amount of the net aggregate underpayment may be recovered from the statutory licensee.

(k) *Frequency of verification.* (1) Except as provided in paragraph (k)(3) of this section, no cable system, MSO, or satellite carrier shall be subject to more than one audit per calendar year and the audit of a particular cable system or satellite carrier shall include no more than two of the Statements of Account from the previous six accounting periods submitted by that cable system or satellite carrier.

(2) Once a notice of intent to audit a Statement of Account has been received by the Office, a notice of intent to audit that same Statement will not be accepted for publication in the *Federal Register*.

(3) If the final auditor's report concludes that there has been a net aggregate underpayment of five percent or more on the audited Statements of Account of a particular cable system or satellite carrier, the participating copyright owners may audit all of the Statements of Account filed by that particular cable system or satellite carrier during the previous six accounting periods by complying with the procedures set forth in paragraphs (c) and (d) of this section. The expanded audit may be conducted by the same auditor that performed the initial

audit, provided that the participating copyright owner(s) provide the statutory licensee with updated information reasonably sufficient to allow the licensee to determine that there has been no material change in the auditor's independence and qualifications. In the alternative, the expanded audit may be conducted by an auditor selected by the licensee pursuant to the procedures set forth in paragraph (e) of this section.

(4) An audit of an MSO shall be limited to a sample of no more than 10 percent of the MSO's Form 3 cable systems and no more than 10 percent of the MSO's Form 2 systems, except that if the auditor concludes that there was a net aggregate underpayment of five percent or more on the Statements of Account at issue in an audit:

(i) The number of Statements of Account of a particular cable system subject to audit in a calendar year may be expanded in accordance with paragraph (k)(3) of this section; and

(ii) The sample of cable systems that may be audited in a calendar year may be expanded in the following calendar year to include a sample of 30 percent of the MSO's Form 3 cable systems and 30 percent of the MSO's Form 2 cable systems.

(l) *Retention of records.* For each Statement of Account that a statutory licensee files with the Copyright Office for accounting periods beginning on or after January 1, 2010, the statutory licensee shall maintain all records necessary to confirm the correctness of the calculations and royalty payments reported in each Statement for at least three and one-half years

after the last day of the year in which that Statement or an amendment of that Statement was filed with the Office and, in the event that such Statement or amendment is the subject of an audit conducted pursuant to this section, for three years after the auditor delivers the final report to the participating copyright owner(s) and the statutory licensee.

(m) *Confidentiality.* (1) For purposes of this section, confidential information shall include any non-public financial or business information pertaining to a Statement of Account that has been subjected to an audit under section 111(d)(6) or 119(b)(2) of title 17 of the United States Code, as amended by Pub. L. 111-175.

(2) Access to confidential information under this section shall be limited to:

(i) The auditor; and

(ii) Subject to executing a reasonable confidentiality agreement, outside counsel for the participating copyright owners and any third party consultants retained by outside counsel, and any employees, agents, consultants, or independent contractors of the auditor who are not employees, officers, or agents of a participating copyright owner for any purpose other than the audit, who are engaged in the audit of a Statement of Account or activities directly related hereto, and who require access to the confidential information for the purpose of performing such duties during the ordinary course of their employment;

(3) The auditor and any person identified in paragraph (m)(2)(ii) of this section shall implement procedures to safeguard all confidential information received from any third party in connection with an audit, using a reasonable standard of care, but no less than the same degree of

security used to protect confidential financial and business information or similarly sensitive information belonging to the auditor or such person.

Dated: May 2, 2013

Maria A. Pallante
Register of Copyrights

[BILLING CODE: 1410-30-S]

[FR Doc. 2013-11020 Filed 05/08/2013 at 8:45 am; Publication Date: 05/09/2013]