LIBRARY OF CONGRESS

U.S. Copyright Office

[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 public roundtable.

SUMMARY: The U.S. Copyright Office will host a public roundtable concerning a new procedure to allow copyright owners to audit the Statements of Account and royalty payments that cable operators and satellite carriers deposit with the Office. The roundtable is intended to elicit specific information concerning the topics listed in this notice. The Office is especially interested in hearing from accounting professionals with experience and expertise in auditing procedures and statistical sampling techniques.

DATES: The public roundtable will be held on July 9, 2014 beginning at 10:00 a.m. at the address listed below. Requests to participate in the roundtable discussion must be submitted in writing no later than June 26, 2014.

ADDRESSES: The public roundtable will take place in the Office of the Register of Copyrights, LM-403 of the Madison Building of the Library of Congress, 101 Independence Avenue SE, Washington, DC 20559. The Office strongly prefers that requests to participate in the discussion be submitted electronically using the form which will be posted on the Office's website at http://www.copyright.gov/docs/soaaudit/public-roundtable/. If electronic submission is not feasible, please contact the Office at (202) 707-8350 for special instructions.

FOR FURTHER INFORMATION CONTACT: Jacqueline C. Charlesworth, General Counsel and Associate Register of Copyrights, by email at jcharlesworth@loc.gov, or by

telephone at 202-707-8350; Erik Bertin, Assistant General Counsel, by email at ebertin@loc.gov, or by telephone at 202-707-8350; or Sarang V. Damle, Special Advisor to the General Counsel, by email at sdam@loc.gov, or by telephone at 202-707-8350.

SUPPLEMENTARY INFORMATION:

I. Background

The Satellite Television Extension and Localism Act of 2010 ("STELA") directed the Register of Copyrights to establish a new procedure to allow copyright owners to audit the Statements of Account ("SOAs") and royalty fees that cable operators and satellite carriers file with the U.S. Copyright Office (the "Office"). *See* 17 U.S.C. 111(d)(6), 119(b)(2). Cable operators and satellite carriers file SOAs and deposit royalties every six months in order to obtain the benefits of the statutory licenses that allow for the retransmission of over-the-air broadcast signals.

On January 31, 2012, a group of copyright owners filed a Petition for Rulemaking and provided the Office with proposed language for the new audit procedure.[1] *See* Petition at 1-4. On June 14, 2012, the Office published a notice of proposed rulemaking that set forth its initial proposal for this new procedure (the "First NPRM"), which was based, in part, on audit regulations that the Office has adopted in the past, as well as the petition that the Office received from the copyright owners. *See* 77 FR 35643 (June 14, 2012).

[1] This group included the Program Suppliers (commercial entertainment programming), Joint Sports Claimants (professional and college sports programming), National Association of Broadcasters ("NAB") (commercial television programming), Commercial Television Claimants (local commercial television programming), Broadcaster Claimants Group (U.S. commercial television stations), American Society of Composers, Authors and Publishers ("ASCAP") (musical works included in television programming), Broadcast Music, Inc. ("BMI") (same), Public Television Claimants (noncommercial television programming), Public Broadcasting Service ("PBS") (same), National Public Radio ("NPR") (noncommercial radio programming), Canadian Claimants (Canadian television programming), and Devotional Claimants (religious television programming).

The Office received extensive comments from groups representing copyright owners, cable operators, and individual companies that use the statutory licenses. The Office carefully studied these comments and revised its proposal based on the suggestions it received. On May 9, 2013 the Office issued a second notice of proposed rulemaking setting forth a revised proposal for the audit procedure (the "Second NPRM"), which was largely based on a joint recommendation that the Office received from certain stakeholders.[2] *See* 78 FR 27137 (May 9, 2013). Once again, the Office received extensive comments.

On December 26, 2013, the Office issued an interim rule that establishes one aspect of the audit procedure (the "Interim Rule"). *See* 78 FR 78257 (Dec. 26, 2013). Specifically, the Interim Rule allows copyright owners to initiate an audit by filing a notice with the Office and by delivering a copy of that notice to the statutory licensee that will be subject to the procedure. *See id.* at 78257. The Office also explained that it was in the process of reviewing the comments submitted in response to the Second NPRM. *See id*. at 78258.

After analyzing the latest round of comments, the Office has decided to revisit several issues that were identified and discussed in the First and Second NPRMs. In addition, the Office has identified some new issues that were not addressed in any of the comments. These issues are described in Sections II.A through II.E below. Many of them are overlapping in the sense that there may be a common solution for multiple issues.

The public roundtable is intended to elicit specific information on these designated topics, preferably from individuals with experience and expertise in accounting. At this time, the Office is seeking input only on the topics specifically mentioned in this notice. Following the

[2] The joint recommendation was submitted by DIRECTV, the National Cable Television Association, and a group representing certain copyright owners, namely, the Program Suppliers, Joint Sports Claimants, ASCAP, BMI, SESAC, the Public Television Claimants, the Canadian Claimants Group, the Devotional Claimants, and NPR.

roundtable, the Office expects to issue another notice of proposed rulemaking (the "Third NPRM"), which will set forth a revised proposal for the audit procedure. The Third NPRM will address various issues that the parties raised in response to the Second NPRM, as well as relevant input that the Office receives during the roundtable. The Third NPRM will be published in the Federal Register and copyright owners, cable operators, satellite carriers, accounting professionals, and other interested parties will be given an opportunity to submit written comments at that time.

II. Topics for the Public Roundtable

A. *Concerns Regarding Backlogs of Pending Audits*

As noted above, the proposed rule set forth in the Second NPRM borrows heavily from the joint recommendation that the Office received from certain stakeholders. After studying the comments received in response to the Second NPRM, the Office is concerned that the audit procedure contemplated by this rule could lead to significant backlogs in pending audits.

This concern arises out of the interplay of several provisions of the proposed rule and the probable timeline for conducting most audits. First, the proposed rule limits the number of SOAs that may be audited at one time. Licensees may be subject to only one audit during a calendar year, and each audit may involve no more than two SOAs. *See* 78 FR at 27152. For multiple system operators ("MSOs"), each audit may cover a sample of no more than ten percent of the MSO's systems, and the audit of each system may involve no more than two SOAs filed by each system. *Id.* at 27153. Significantly, the Second NPRM made clear that if a single audit spanned multiple years, the licensee would not be subject to any other audits during those years. For example, if an auditor initiated an audit in 2013, and delivered his or her final report in 2014, the licensee could not be subject to any other audits in calendar year 2013 or 2014, because the

licensee would already be subject to an audit during those years. *See id.* at 27143. If copyright owners wished to audit additional SOAs filed by that licensee, they would have to wait until calendar year 2015 to review those statements.

These limitations come with a safety valve of sorts: if the auditor concludes that there was a net aggregate underpayment of five percent or more, the copyright owners could audit all of the SOAs that the licensee filed during the previous six accounting periods.[3] *Id.* at 27153. But while this expanded audit was taking place copyright owners would be barred from commencing a separate audit of other SOAs filed by that licensee (*e.g.*, more recently filed SOAs that were not included in the current audit).

Second, under the Interim Rule, a copyright owner may preserve the right to audit a particular SOA so long as it files a notice of intent within three years after the last day of the year in which that statement was filed. 37 CFR 201.16(c)(1). Notably, however, the Interim Rule and the proposed rule do not specify a precise deadline by which a copyright owner must commence the actual audit. Likewise, the Office did not propose any deadline for the completion of a full audit, although the proposed rule included a detailed description of the steps necessary to complete the audit and provided several interim deadlines for completing some of those steps.

The Office offered these proposals on the assumption that most audits could be completed within a single calendar year. But that may not be a realistic assumption in some cases, especially where the copyright owners conduct an expanded audit or where a licensee fails to cooperate with an auditor's requests for documentation in a timely manner. If an audit is not

[3] In the case of an audit involving an MSO the copyright owners would be permitted to audit up to thirty percent of the MSO's systems and for each of those systems the auditor would be permitted to review up to six SOAs from the previous six accounting periods.

completed in the expected time frame, a backlog of pending audits could easily develop. For instance, if copyright owners initiate an audit of a cable operator's SOAs for the 2014-1 and 2014-2 accounting periods during calendar year 2015, those audits would have to be fully completed by December 31, 2015 if copyright owners want to audit the operator's SOAs for the 2015-1 and 2015-2 accounting periods in calendar year 2016. But if the audit of the 2014 SOAs extended into January of 2016, the fact that an operator would be subject to no more than one audit per calendar year would force the copyright owners to wait until the start of 2017 to begin the audit of the 2015 SOAs. And if the audit of the 2015 SOAs did not conclude by December 31, 2017, copyright owners would have to wait until 2019 to initiate a new audit involving no more than two of the seven other SOAs that the operator filed in 2016, 2017, 2018, and 2019. At the same time, the copyright owners could indefinitely preserve the right to audit those seven SOAs under the Interim Rule by timely filing notices of intent within the applicable three-year deadline. *See* 37 CFR 201.16(c)(1).

The problem of backlogs appears especially acute in the case of MSOs. Under the proposed rule, copyright owners are permitted to file notices of intent to audit the SOAs filed by *all* of the cable systems owned by an MSO, but in any given year they may audit only ten percent of those systems. As a result, backlogs would occur immediately and it could conceivably take decades for copyright owners to verify all of the statements that they wish to review for a given period.

Such backlogs would obviously place an undue burden on both copyright owners and licensees. Copyright owners should be able to audit an SOA within a reasonable amount of time after it is filed, but this may not be possible if there are many pending audits in the queue. In such cases, copyright owners may feel obligated to file notices of intent to audit on a routine

basis in order to preserve the option of auditing a particular licensee, even if they do not expect to proceed with the audit in the foreseeable future. At the same time, the licensee might be required to maintain records related to SOAs for many years before an audit gets underway, which creates administrative burdens and could increase the risk that records may be lost or damaged in the interim.

The Office would like to discuss the concerns described above, and is interested in hearing stakeholders' views on possible safeguards against such backlogs. We believe there are a number of solutions that, individually or taken together, could help mitigate these concerns. One possibility is to set precise deadlines for starting and completing each audit. Once a notice has been filed with the Office, should the auditor be required to begin his or her review within a specified period of time? If so, should the deadline be one month, three months, six months, or some other time period? If the auditor does not proceed with the audit in a timely manner, should the copyright owners lose the opportunity to audit the SOAs identified in the notice of intent to audit? Once the audit begins, should the auditor be required to complete his or her review within a specified period of time? Should the licensee be penalized (for example, by allowing the commencement of a concurrent audit) if the auditor determines that the licensee did not reasonably cooperate with his or her requests and that this compromised the auditor's ability to complete the audit within the time allowed?

Another possibility is to loosen the restrictions on the number of SOAs that may be included in each audit or the number of separate audits that can take place at any given time. Would it be more efficient to allow the copyright owners to audit more than two SOAs at a time? If the typical audit may require more than twelve months, would it be preferable if the licensee

were subject to no more than one audit at a time, rather than no more than one audit per calendar year? Are there circumstances where it might make sense to allow audits to overlap?

We are particularly interested in hearing potential solutions to the problem of MSOs. In the case of an audit involving an MSO, would it be reasonable to apply the auditor's findings to SOAs filed by other systems that were not included in the audit? In other words, if the auditor discovers an underpayment or overpayment in the SOAs filed by ten percent of the MSO's Form 2 and Form 3 systems, is it reasonable to assume that the auditor would find similar discrepancies in the SOAs filed by the other systems owned by that MSO? What accounting methods, if any, could be used to extrapolate findings for one system to the other systems? Should the final rule specify the methods that may be used for this purpose? Should an MSO be given the opportunity to include a larger sample of systems in the audit if it is concerned that statistical sampling may yield unreliable results? If the auditor is allowed to audit more than two SOAs and/or to apply his or her findings to multiple cable systems, would there be any need to allow copyright owners to expand the scope of the initial audit to preceding periods as contemplated by the Second NPRM?

In addition, there may be other possibilities for avoiding potential backlogs that the Office has not considered, and we welcome other ideas that could mitigate the significant concern that the audit process could lag far behind periods for which review may be sought.

B. *The Proper Auditing Standard*

The proposed rule set forth in the Second NPRM specifies that the audit must be conducted "according to generally accepted auditing standards." 78 FR at 27151. Guidance from the American Institute of Certified Public Accountants ("AICPA") indicates that "generally accepted auditing standards" are those that are used by accountants to audit corporate financial

statements.[4] In modern accounting practice, are "generally accepted auditing standards" the proper standards to apply to the audits contemplated here? Or is there an alternative approach, such as "attestation standards," that might be more appropriate?[5]

C. *Limitation on* Ex Parte *Communications*

The Second NPRM contains a detailed provision governing *ex parte* communications. Specifically, the provision bans *ex parte* communications regarding the audit between the selected auditor and the participating copyright owners, except in certain narrow circumstances. The Office included this provision based on the joint stakeholder's recommendation and with the understanding that this provision was intended to maintain the independence of the auditor. *See* 78 FR at 27151. We note, however, that such a restriction does not appear in other audit regulations promulgated by the Copyright Office or the Copyright Royalty Board.[6] Could this restriction create inefficiencies in the audit process by preventing copyright owners from communicating with the auditor without first coordinating with the licensee? Is this restriction consistent with the relevant professional standards for auditors? Are the concerns that prompted the joint stakeholders to recommend this provision already addressed by those professional standards?

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

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[4] *See* AICPA, Clarified Statements on Auditing Standards AU-C Section 200.01, *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00200.pdf.

[5] *See* AICPA, *Statements on Standards for Attestation Engagements* at Section 101.01, *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AT-00101.pdf.

[6] *See* 37 CFR 201.30 (verification of SOAs filed under Section 1003(c)); 37 CFR 380.6 and 380.7 (verification of royalty payments made by commercial and noncommercial webcasters under Sections 112(e) and 114); 37 CFR 380.15 and 380.16 (verification of royalty payments made by broadcasters under Sections 112(e) and 114); 37 CFR 380.25 and 380.26 (verification of royalty payments made by noncommercial educational webcasters under Sections 112(e) and 114); 37 CFR 382.6 and 382.7 (verification of royalty payments made by nonexempt preexisting subscription services under Sections 112(e) and 114); 37 CFR 382.15 and 382.16 (verification of royalty payments made by preexisting satellite digital audio radio services under Sections 112(e) and 114); 37 CFR 384.6 and 384.7 (verification of royalty payments made by business establishment services under Section 112(e)).

Section 111(d)(6) of the Copyright Act directs the Office to issue regulations that "require a consultation period for the independent auditor to review its conclusions with a designee of the cable system," "establish a mechanism for the cable system to remedy any errors identified in the auditor's report," and "provide an opportunity to remedy any disputed facts or conclusions." 17 U.S.C. 111(d)(6)(C).

The Second NPRM proposed to implement this directive by requiring the auditor to prepare a written report setting forth his or her conclusions, to consult with the licensee for a period of thirty days, and, if the auditor agreed that a mistake had been made, to correct the report before delivering it to the copyright owners. *See* 78 FR at 27144-45. If the auditor and the licensee are unable to resolve their disagreements, the proposed rule states that the licensee may prepare a written response within fourteen days thereafter, which would be attached as an exhibit to the auditor's final report. *Id.*

After further analysis, the Office is concerned that this may be unduly restrictive, in part due to the time constraints imposed by the proposed rule. The Office would like to know whether the auditor and licensee should have more flexibility in conducting this phase of the audit to increase the possibility that points of disagreement can be resolved. For instance, the Copyright Royalty Board adopted audit regulations for royalty payments made under Sections 112(e) and 114 that simply state, "the auditor shall review the tentative written findings of the audit with the appropriate agent or employee of the Licensee being audited in order to remedy any factual errors and clarify any issues relating to the audit; [p]rovided that an appropriate agent or employee of the Licensee reasonably cooperates with the auditor to remedy promptly any

factual errors or clarify any issues raised by the audit."[7] Should the Office consider a similar approach for audits involving cable operators and satellite providers? If so, how might such an approach impact the timing and completion of audits?

If the Office retains the approach set forth in the Second NPRM, should the licensee be given an opportunity to review the initial draft of the auditor's report before the consultation period begins? Is thirty days a sufficient amount of time for the consultation period? Should the auditor provide the licensee with a revised draft of the report at the end of the consultation period reflecting any errors or mistakes that have been corrected? If the licensee disagrees with the conclusions set forth in the revised draft, should the licensee be given an opportunity to prepare a written response, and if so, is fourteen days a sufficient amount of time to prepare that response? Should the auditor be given more than five days to prepare the final draft of his or her report?

E. *Cost of the Audit Procedure*

The Office would appreciate input on two issues related to the cost of the audit procedure. First, the proposed rule set forth in the Second NPRM states that if the auditor discovers a net aggregate underpayment of more than ten percent, the statutory licensee shall pay the copyright owners for the cost of the audit. *See* 78 FR at 27152. If, however, "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 [ten] percent and not less than

[7] 37 CFR 380.6(f) and 380.7(f) (royalty payments made by commercial and noncommercial webcasters). Similar language appears in the regulations governing the verification of royalty payments made by broadcasters (37 CFR 380.15(f) and 380.16(f)), noncommercial educational webcasters (37 CFR 380.25(f) and 380.26(f)), preexisting satellite digital audio radio services (37 CFR 382.15(f) and 382.16(f)), and business establishment services (37 CFR 384.6(f) and 384.7(f)).

[five] percent, the costs of the auditor shall be split evenly between the statutory licensee and the participating copyright owners." *Id.*

The Office is inclined to keep the provision providing for cost shifting where the auditor concludes there was a net aggregate underpayment of more than ten percent. But after further analysis, we question whether the provision providing for cost splitting should be included in the final rule. Under the proposed rule, the determination of whether there has been a net aggregate underpayment would be based on the auditor's *final* report, *i.e.*, *after* the auditor has evaluated the licensee's "written explanation of its good faith objections" to the initial report. If the auditor considered and rejected those objections, it is unclear why they should gain renewed significance for the purpose of allocating costs. Would it make more sense to adopt a simple rule that the copyright owners would pay the audit costs if the final report concludes that the underpayment is ten percent or less, and the licensee would pay the cost if the final report concludes that the underpayment is more than ten percent (with the qualification that the licensee would never be required to pay costs that exceed the amount of the underpayment identified in the final report)?

Second, the proposed rule states that "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 [ten] percent or less, the participating copyright owner(s) shall reimburse the licensee, within [sixty] days of the final judgment, for any costs of the auditor that the licensee has paid." 78 FR at 27152. In the Second NRPM the Office assumed that if the licensee disagrees with the auditor's conclusions, the licensee might seek a declaratory judgment of non-infringement and an order directing the copyright owners to reimburse the licensee for the cost of the audit. *See* 78 FR at 27149. Do the parties in fact expect to be engaged in this sort of litigation as an outgrowth of the audit process? Do stakeholders anticipate that a royalty underpayment or overpayment

would be addressed in a federal infringement (or non-infringement) action? Have the stakeholders given any thought to whether or how the statute of limitations might affect such claims? Should the appropriate remedy in any such proceeding, including reimbursement of audit costs, be left to the court?

In any event, if it is necessary to include a provision requiring the copyright owners to reimburse the licensee, we are interested in the stakeholders' views on alternate ways in which this might be accomplished, given the concerns expressed by some commenters about the potential difficulty of recovering costs from multiple copyright owners in the event an auditor's findings are overturned. *See* AT&T Second Comment at 2; ACA Second Comment at 3-4. If the licensee disagrees with the auditor's conclusions, should the licensee place the cost of the audit procedure into escrow pending the resolution of any litigation between the licensee and the copyright owners? Should the licensee be required to release those funds to the copyright owners if the parties fail to take legal action within a specified period of time? If so, what would be a reasonable amount of time for the funds to remain in escrow?

III. Requests to Participate in the Public Roundtable

The Office invites copyright owners, cable operators, satellite carriers, accounting professionals, and other interested parties to participate in the public roundtable to address these issues. The Office is particularly interested in hearing from accounting professionals with experience and expertise regarding auditing procedures and statistical sampling techniques. The Office encourages parties that share interests and views to designate common spokespeople to discuss the topics listed in this notice. The Office also encourages copyright owners and licensees to confer with each other prior to the meeting to identify common ground or areas of disagreement concerning these issues.

Persons wishing to participate in the discussion should submit a request electronically no later than June 26, 2014 using the form posted on the Office's website at http://www.copyright.gov/docs/soaaudit/public-roundtable/. If electronic submission is not feasible, please contact the Office at (202) 707-8350 for special instructions. Seating in the room where the roundtable will be held is limited and will be offered first to persons who submitted a timely request to participate. To the extent available, observer seats will be offered on a first-come, first-served basis on the day of the meeting.

Parties do not need to submit written comments or prepared testimony in order to participate in the public roundtable. However, the Office strongly encourages participants to familiarize themselves with the Notices of Proposed Rulemaking and the Interim Rule that the Office issued in this proceeding, as well as the questions presented in this notice and the comments that have been submitted to date.

Dated: May 28, 2014.

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Jacqueline C. Charlesworth,
General Counsel and
Associate Register of Copyrights.

[BILLING CODE 1410-30-P]

[FR Doc. 2014-12755 Filed 06/02/2014 at 8:45 am; Publication Date: 06/03/2014]