



## **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.

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**SUMMARY:** On May 9, 2013 the U.S. Copyright Office issued 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 Office for secondary transmissions of broadcast programming made pursuant to statutory licenses. The Office has revised the proposed regulation to address certain logistical concerns and based on further input that it has received from copyright owners, cable operators, satellite carriers, and accounting professionals. The Office seeks comments on the revised proposal before it is adopted as a final rule.

**DATES:** Comments must be made in writing and must be received in the U.S. Copyright Office no later than [INSERT DATE 30 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** The U.S. Copyright Office strongly prefers that comments be submitted electronically. A comment page containing a comment submission form is posted on the Office's website at [http://copyright.gov/docs/soaaudit/soa\\_audit.html](http://copyright.gov/docs/soaaudit/soa_audit.html). The website

interface requires submitters to complete a form specifying a name and organization, as applicable, and to upload comments as an attachment. To meet accessibility standards, all comments must be uploaded in a single file in either Portable Document Format (PDF) that contains searchable, accessible text (not an image); Word format (DOC or DOCX); WordPerfect format (WPD); Rich Text Format (RTF); or ASCII text file (not a scanned document). The maximum file size for comments is six megabytes (MB). The name of the commenter and organization should appear on both the form and on the comment itself. All comments will be posted publicly on the Office's website exactly as they are received, along with names and organizations. If electronic submission of comments 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](mailto:jcharlesworth@loc.gov), or by telephone at 202-707-8350; Erik Bertin, Assistant General Counsel, by email at [ebertin@loc.gov](mailto:ebertin@loc.gov), or by telephone at 202-707-8350; or Sy Damle, Special Advisor to the General Counsel, by email at [sdam@loc.gov](mailto:sdam@loc.gov), or by telephone at 202-707-8350.

**SUPPLEMENTARY INFORMATION:**

**I. Background.**

Sections 111 and 119 of the Copyright Act (the "Act"), Title 17 of the United States Code, allow cable operators and satellite carriers to retransmit programming that broadcast stations transmit on over-the-air broadcast signals. To use these statutory licenses, cable operators and satellite carriers are required to file statements of account ("SOAs") and deposit royalty fees with the U.S. 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 that are entitled to receive a share of the royalties.

The Satellite Television Extension and Localism Act of 2010 (“STELA”), Pub. L. No. 111-175, amended the Act by directing the Register of Copyrights to issue regulations to allow copyright owners to audit the SOAs and royalty fees that cable operators and satellite carriers file with the Office. Section 119(b)(2) of the Act directs 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 this subsection.” 17 U.S.C. 119(b)(2). Similarly, section 111(d)(6) directs 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.” 17 U.S.C. 111(d)(6).

The Office began working on its initial draft for this procedure in 2011. The initial draft was based on similar audit 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.

On January 31, 2012 the Office received a Petition for Rulemaking, which was filed by a group of copyright owners.<sup>1</sup> The copyright owners urged the Office to adopt regulations that would allow them to audit the SOAs filed by cable operators and satellite carriers, and they provided the Office with proposed language for each regulation. *See* Petition at 1-4.

On June 14, 2012, the Office issued a Notice of Proposed Rulemaking that set forth its initial proposal for the audit procedure (the “First Proposed Rule”). *See* 77 FR 35643 (June 14, 2012). The Office received extensive comments from groups representing copyright owners,<sup>2</sup> cable operators,<sup>3</sup> and individual companies that retransmit broadcast programming under sections 111 or 119 of the Act, namely, AT&T, Inc., DIRECTV, LLC, and DISH Network L.L.C.<sup>4</sup>

In lieu of reply comments, DIRECTV, the NCTA, and a group representing certain copyright owners<sup>5</sup> submitted a joint proposal for revising the First Proposed Rule. This group referred to themselves collectively as the “Joint Stakeholders,” and they urged

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<sup>1</sup> 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).

<sup>2</sup> This group included the Program Suppliers, Joint Sports Claimants, Commercial Television Claimants, Broadcaster Claimants Group, ASCAP, BMI, SESAC, Inc., Public Television Claimants, Canadian Claimants, NPR, and Devotional Claimants. The NAB and PBS did not submit comments in response to the First Proposed Rule.

<sup>3</sup> The National Cable & Telecommunications Association (“NCTA”) and the American Cable Association (“ACA”) filed comments on the First Proposed Rule on behalf of cable operators.

<sup>4</sup> Citations to the comments and reply comments submitted in response to the First Proposed Rule are abbreviated “[Name of Party] First Comment” and “[Name of Party] First Reply.”

<sup>5</sup> The copyright owners that joined the NCTA and DIRECTV in submitting the Joint Stakeholders’ First Submission include the Program Suppliers, Joint Sports Claimants, ASCAP, BMI, SESAC, Public Television Claimants, Canadian Claimants Group, Devotional Claimants, and NPR. The Commercial Television Claimants, the Broadcaster Claimants Group, the NAB, and PBS did not join their fellow copyright owners in submitting this proposal.

the Office to incorporate their suggestions “as promptly as possible after receiving any further public comment.” JS First Submission at 1.<sup>6</sup> The Office also received reply comments from AT&T. AT&T explained that it was aware of the Joint Stakeholders’ negotiations and the “potential areas of agreement” among the parties, but stated that it did not have a sufficient amount of time for “meaningful engagement” with the group. AT&T First 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 studied the Joint Stakeholders’ proposal and the other comments and reply comments submitted in response to the First Proposed Rule. The Joint Stakeholders’ proposal addressed many of the concerns that the parties raised in their initial comments. The Office therefore incorporated most of the Joint Stakeholders’ suggestions into a revised proposed regulation (the “Second Proposed Rule”).

On May 9, 2013, the Office published the Second Proposed Rule in the *Federal Register* and invited AT&T, DISH, the ACA, the Broadcaster Claimants Group, the Commercial Television Claimants, and other interested parties to comment on the proposed regulation. The Office also invited reply comments from the Joint Stakeholders and other interested parties. *See* 78 FR 27137, 27138 (May 9, 2013). The Office received comments from AT&T and the ACA, and it received reply comments from the ACA, the NCTA, and a group representing the copyright owners (“Copyright Owners”) that negotiated the Joint Stakeholders’ Proposal with the NCTA and DIRECTV.<sup>7</sup> The

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<sup>6</sup> Citations to the proposals submitted by the Joint Stakeholders are abbreviated “JS First Submission” and “JS Second Submission.”

<sup>7</sup> Citations to the comments and reply comments submitted in response to the Second Proposed Rule are abbreviated “[Name of Party] Second Comment” and “[Name of Party] Second Reply.” For example,

parties raised a number of complex issues, including issues of first impression that were not addressed in the comments or reply comments submitted in response to the First Proposed Rule.

On December 26, 2013, the Office issued an interim rule that addresses a procedural issue that was not contested by the parties (the “Interim Rule”). Specifically, the Interim Rule allows copyright owners to identify any SOAs from accounting periods beginning on or after January 1, 2010 that they intend to audit. At the same time, it provides licensees with advance notice of the SOAs that will be subject to audit when the final rule goes into effect. *See* 78 FR 28257 (Dec. 26, 2013).

After analyzing the latest round of comments, the Office identified a number of issues that were not addressed in the First or Second Proposed Rules or in the comments submitted in response to those proposals. Because the Office believed these issues might be narrowed through group discussion, it decided to convene a public roundtable before issuing another notice of proposed rulemaking. *See* 79 FR 31992 (June 3, 2014). During the roundtable the Office received valuable input from parties that previously submitted comments in this proceeding, including the Motion Picture Association of America (“MPAA”), the Commissioner of Baseball, the NCTA, the ACA, and DIRECTV. The Office also received guidance from Crunch Digital, a company that conducts audits on behalf of content owners and licensees in the music industry.

The issues discussed at the roundtable are summarized in the Office’s *Federal Register* notice dated June 3, 2014 (the “Roundtable Notice”). The most significant

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citations to the Copyright Owners’ reply comments are abbreviated “CO Second Reply.” This group includes all the copyright owners listed in footnote five, but as mentioned in that footnote, the Commercial Television Claimants, the Broadcaster Claimants Group, the NAB, and PBS did not join their fellow copyright owners in submitting the Joint Stakeholders’ First Submission.

concern was the potential for backlogs to develop as a result of the limit on the number of SOAs that could be audited at any one time under the existing proposal.<sup>8</sup> The Office also expressed concern about the accounting standards that should be applied during the audit, the limitation on *ex parte* communications between the auditor and the copyright owners, the amount of time allocated for consultations between the auditor and the licensee, and the procedure for allocating the costs of the audit between the copyright owners and the licensee. *See* 79 FR at 31994-95.

Following the roundtable, the Joint Stakeholders consulted with each other regarding three of these issues, namely: (i) requiring an initial consultation between the auditor and a representative of the licensee and the participating copyright owners prior to the commencement of an audit; (ii) the accounting standard that should govern the audit; and (iii) the procedure for allocating the cost of an audit between the participating copyright owners and the licensee. On July 31, 2014, the Joint Stakeholders informed the Office that they had reached a consensus on two of these issues and they offered specific recommendations for modifying certain aspects of the proposed rule.<sup>9</sup> JS Second Submission at 1-2.

After reviewing the comments and reply comments submitted in response to the Second Proposed Rule, the input provided during the roundtable, and the Joint Stakeholders' Second Submission, the Office made several changes to the proposed rule

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<sup>8</sup> Under the Second Proposed Rule a satellite carrier or a particular cable system would be subject to no more than one audit per calendar year and each audit would involve no more than two SOAs filed by that licensee. For multiple system operators ("MSOs"), the audit would be limited to a sample of no more than ten percent of the MSO's systems, and the audit of each system would involve no more than two SOAs filed by each system. The Second Proposed Rule also provided that if a single audit required multiple years to complete, the licensee would not be subject to any other audits during those years. *See* 78 FR at 27143; 79 FR at 31993.

<sup>9</sup> The parties that submitted these recommendations are identified in footnote five.

(the “Third Proposed Rule”).<sup>10</sup> The Office invites public comment from copyright owners, cable operators, satellite carriers, accounting professionals, and other interested parties concerning the proposed modifications that are discussed below in sections II, III.A, III.B, VI.A, VI.B, VII.A, VII.B, and VIII.C.<sup>11</sup>

## **II. Audit Notice, Timetable, and Transitional Provisions.**

### *A. Initial Audits.*

Under the Second Proposed Rule, a copyright owner could initiate an audit by filing a written notice with the Office that identified the statutory licensee, the SOAs, and the accounting periods that would be subject to the audit. The Office would publish a notice in the *Federal Register* announcing the receipt of the notice of intent to audit, and within thirty days thereafter, any other copyright owner that wished to participate in the audit would be required to notify both the copyright owner that filed the notice and the licensee that would be subject to the audit. Copyright owners that failed to comply with this requirement would not be permitted to participate in the audit process and would not be permitted to audit the same SOAs in a subsequent proceeding.

The Third Proposed Rule modifies this portion of the audit procedure in several respects. It provides that the notice should include the copyright owner’s name, address, telephone number, and email address (but need not include a fax number). To facilitate the submission of notices, the Third Proposed Rule provides that notices should be addressed to the “U.S. Copyright Office, Office of the General Counsel,” and specifies the mailing address for time-sensitive materials where notices should be sent. It also

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<sup>10</sup> For the convenience of the parties, the Office created a document that illustrates the differences between the Second Proposed Rule (as it was modified by the Interim Rule) and the Third Proposed Rule. This document is available on the Office’s website at [http://copyright.gov/docs/soaaudit/soa\\_audit.html](http://copyright.gov/docs/soaaudit/soa_audit.html).

<sup>11</sup> The Office has reached a final decision concerning the topics discussed in sections III.C, III.D, IV, V, VII.C, VIII.A, VIII.B, or IX. Therefore, the Office does not invite further comment on these topics.



establishes similar – but separate – procedures for submitting a notice of intent to conduct an initial audit and a notice of intent to conduct an expanded audit.<sup>12</sup>

Under the Third Proposed Rule a notice of intent to conduct an initial audit must be received in the Office between December 1st and December 31st. The Office will publish a notice in the *Federal Register* announcing the receipt of that notice between January 1st and January 31st of the next calendar year. By contrast, a notice of intent to conduct an expanded audit may be filed at any point during the calendar year, provided that the notice is received within three years after the last day of the year in which any statement to be reviewed was filed with the Office. When the Office receives a notice of intent to conduct an expanded audit, it will publish a notice in the *Federal Register* within thirty days thereafter announcing the receipt of the notice. As the Office noted in its *Federal Register* document dated May 9, 2013, this step is intended to give copyright owners that did not join the initial audit an opportunity to participate in the expanded audit. *See* 78 FR at 27143.

The Office decided to modify the timing of the receipt and publication of the initial notice to prevent the development of backlogs in pending audits. This concern stemmed from the fact that – under the Second Proposed Rule – a licensee could be subject to only one audit during a calendar year, but there was no assurance that any given audit would be started and finished within a single calendar year. *See* 79 FR at 31993. Indeed, the Second Proposed Rule made clear that if a single audit spanned

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<sup>12</sup> As discussed in sections II.B and VII, the Third Proposed Rule limits the number of SOAs and the number of cable systems that may be included in an initial audit, but if the auditor discovers an underpayment that exceeds a certain threshold, the copyright owners may expand the scope of the initial audit to include other SOAs and other cable systems that have not been audited before.

multiple years, the licensee would not be subject to any other audits during those years. *See* 78 FR at 27153.

At the roundtable, several participants suggested that the Office's concerns were unwarranted, because they expected audits to be completed within relatively short periods of time. The MPAA explained that it has audited SOAs on an informal basis for many years. According to the MPAA, before an audit begins, copyright owners often have a sense of what the problems may be based on the information already provided in the licensee's SOAs, and thus will be able to give the auditor a sense of what he or she should focus on from the outset. The MPAA stated that the most difficult part of the audit process is identifying the stations and signals carried by the provider. Under the proposed rule, the licensee would be required to provide this information at the outset. Therefore, the MPAA is of the view that the audit as a whole would be expected to proceed smoothly. The MPAA predicted that an audit involving a small cable system could be completed within a few weeks, while an audit of a large cable system might require three months. In response to the Office's concerns that some licensees may not be diligent in responding to the auditor's requests for information, the MPAA indicated that in its experience this was not a problem. According to the MPAA, copyright owners and licensees traditionally have been cooperative during the audit process, with disputes typically resolved through settlement and voluntary adoption of corrective practices.

While the Office appreciates the MPAA's experience, it is concerned that the level of cooperation experienced by the MPAA during these voluntary informal audits might not be universal. Indeed, as the NCTA observed in its written comments, "no one

can predict at this point how smoothly the audit process will be for the cable and satellite industries.” NCTA Second Reply at 6.

As discussed in section IV.C, the Third Proposed Rule will allow licensees to suspend the audit for several months during each year. The Office is concerned that the audit process may be delayed even further if the licensee fails to respond to the auditor’s requests in a timely manner. The Office believes that this is a real possibility given that – under the Joint Stakeholders’ first proposal and the Second Proposed Rule – prolonging an audit into the next calendar year would preclude the copyright owners from commencing another audit involving that same licensee, thus creating an incentive for delay. *See* JS First Submission at 9-10; 78 FR at 27143; 79 FR at 31993. The roundtable revealed that, apart from the MPAA, none of the cable or satellite industry representatives in attendance has had any meaningful experience with audits involving SOAs. At the same time, the Office is aware that royalty audits of other types of content licensees may well take longer than a year to complete.

The Third Proposed Rule addresses this concern by establishing a schedule that is intended to ensure that the initial audit will be completed within a single calendar year. Specifically, it will require the copyright owners to file a notice of intent to conduct an initial audit during the month of December in the year before the audit is to begin, will require the Office to publish a notice in the *Federal Register* during January of the following year, and will require the auditor to deliver his or her final report to the participating copyright owners by November 1st of that same year.<sup>13</sup>

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<sup>13</sup> Under the Third Proposed Rule, a statutory licensee will be subject to no more than one initial audit per calendar year, and an initial audit involving a particular satellite carrier or a particular cable system will be limited to no more than two of the SOAs filed by that licensee. But, as discussed in section VII.B, these

This approach provides advantages over the Second Proposed Rule, which would have allowed the copyright owners to commence an initial audit at any time during the year. For instance, the Third Proposed Rule will substantially alleviate administrative burdens on the Office related to initial audits since notices will arrive in the Office within a set period of time, which in turn will allow the Office to publish them in the *Federal Register* as a group instead of publishing them on a piecemeal basis. In addition, this approach will improve certainty for both the copyright owners and statutory licensees. Copyright owners will be able to better coordinate their collective auditing activities, since notices of intent to conduct an initial audit will be submitted to the Office and published in the *Federal Register* at the same time each year. Likewise, a routine schedule for the submission and publication of notices will allow licensees to organize their affairs, because each December they will know whether they will be subject to an initial audit in the following calendar year.

In order to comply with the time limits set forth in section 111(d)(6)(E) of the Act, the copyright owners must file a notice of intent to audit a particular SOA within three years after the last day of the year in which the SOA was filed with the Office (regardless of whether they intend to conduct an initial audit or an expanded audit). The Third Proposed Rule recognizes that in any given year the copyright owners may file a notice of intent to conduct an initial audit involving any two of the SOAs that the licensee filed with the Office during that year or the three previous<sup>14</sup> calendar years. Once the Office receives a notice of intent to conduct an initial audit involving two SOAs filed by a

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limits will not apply to an expanded audit, which could be conducted concurrently with an initial audit involving the same licensee.

<sup>14</sup> In this context, the word “previous” means an SOA filed prior to the date that the copyright owners filed a notice of intent to audit with the Office.

particular satellite carrier or a particular cable system, the Office will not accept a notice of intent to conduct an initial audit involving that same carrier or that same system until the following calendar year.

*B. Expanded Audits.*

Under the Third Proposed Rule, if the auditor discovers a net aggregate underpayment<sup>15</sup> of five percent or more during an initial audit of a satellite carrier or a single cable system, the copyright owners may expand the scope of the audit to include previous<sup>16</sup> SOAs filed by that licensee. If the auditor makes such a finding during an initial audit involving a sample of cable systems that are owned by a multiple system operator (“MSO”), the copyright owners may expand the scope of that audit to include previous SOAs filed by those cable systems, and in the following calendar year, the copyright owners may conduct an initial audit involving a larger sample of the cable systems owned by that MSO.

During an expanded audit the copyright owners would be able to audit any of the previous statements filed by the licensee, as long as they file a notice of intent to audit those statements within three years after the last day of the year in which those statements were filed with the Office. 17 U.S.C. 111(d)(6)(E). Although a notice of intent to conduct an initial audit must be filed in December and although the initial audit must be completed by November 1st of the following year, these requirements will not apply to expanded audits. Under the Third Proposed Rule a notice of intent to conduct an

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<sup>15</sup> The Second Proposed Rule defined “net aggregate underpayment” as 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. *See* 78 FR at 27150. The same definition also appears in the Third Proposed Rule.

<sup>16</sup> In this context, the word “previous” means SOAs filed before the SOAs that were reviewed during the initial audit. *See* 78 FR at 27143.

expanded audit may be filed during any month, and the auditor does not need to deliver his or her final report by November 1st of any given year.

*C. Notices Filed Under the Interim Rule.*

Assuming the Third Proposed Rule is adopted as a final rule, it will supersede the Interim Rule in its entirety. Until then, copyright owners may use the Interim Rule to preserve their right to audit any SOA that was filed with the Office for accounting periods 2010-2 through 2014-1,<sup>17</sup> so long as the notice is received in a timely manner.<sup>18</sup>

If a copyright owner does file a notice of intent to audit before the Third Proposed Rule goes into effect, then, as stated in the Interim Rule, the Office will publish that notice in the *Federal Register* within thirty days after it is received in the Office. See 37 CFR 201.16(c)(1). In such cases, the Third Proposed Rule provides that the audit shall be conducted using the procedures set forth in the proposed rule, except that regardless of the timing of the notice and its publication pursuant to the Interim Rule, the copyright owners must provide the licensee with a list of proposed auditors by March 16, 2015, and the auditor must deliver his or her final report to the copyright owners and the licensee by November 1, 2015.

**III. Commencement of the Audit.**

*A. Designation of the Auditor.*

The Second Proposed Rule provided that the copyright owners must deliver a list of three independent and qualified auditors to the licensee, along with information that is

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<sup>17</sup> The deadline for filing a notice of intent to audit a statement for the 2010-1 accounting period expired on December 31, 2013, and as discussed in the *Federal Register* document dated June 14, 2012, statements covering accounting periods that began before January 1, 2010 are not subject to audit under this procedure. See 77 FR at 35645.

<sup>18</sup> To date, the Office has not received any notices filed pursuant to the Interim Rule.

reasonably sufficient for the licensee to evaluate the independence and qualifications of each individual. Within five business days thereafter, the licensee would be required to select one of these individuals to conduct the audit. *See* 78 FR at 27139-40. None of the parties objected to this aspect of the Second Proposed Rule.

The Interim Rule allows a copyright owner to 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). However, the Interim Rule does not specify a precise deadline by which a copyright owner must commence the actual audit. As the Office observed in the Roundtable Notice, 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 statement, even if they do not expect to proceed with the audit in the foreseeable future. 79 FR 31993. In such cases, the licensee might be required to maintain records related to SOAs for many years before an audit got underway, which would create administrative burdens and increase the risk that records would be lost or damaged in the interim.

The Third Proposed Rule addresses this concern by establishing a deadline for commencing the audit. Specifically, it provides that the participating copyright owners must deliver the list of prospective auditors to the licensee within forty-five days after the date that the Office publishes a notice in the *Federal Register* announcing the receipt of the notice of intent to audit. Once the licensee has made its selection, the Third Proposed Rule provides that the licensee must notify the participating copyright owners and the participating copyright owners must retain the auditor that the licensee selected. It also provides that if the copyright owners fail to deliver a list of prospective auditors to the

licensee within the time allowed or fail to retain the auditor that the licensee selected, the SOAs identified in the notice of intent to audit shall not be subject to audit.

*B. Initial Consultation with the Auditor.*

At the roundtable, the audit firm Crunch Digital explained that it typically schedules a “kick-off call” at the start of each of its audits. During this call, the auditor and the party that is subject to the audit identify the types of books and records that the auditor intends to examine and the parties set a mutually agreeable schedule for the production of those items. In addition, each party designates a contact person who will be responsible for receiving and responding to communications regarding the audit. Crunch Digital explained that this improves the efficiency of the examination process, thus reducing the overall cost of the audit. The Joint Stakeholders made a similar recommendation in their Second Submission and the Office has incorporated that suggestion into the proposed rule. JS Second Submission at 1. Specifically, the Third Proposed Rule provides that the auditor shall meet with designated representatives of the licensee and the participating copyright owners (either in person or by telephone) within ten days after he or she has been selected. During the consultation, the parties are to review the scope of the audit, the methodology that the auditor will use during his or her review, and the schedule for conducting and completing the audit. The objective of this consultation is to establish the schedule and procedures for the production and review of information so that the audit will be completed in a timely fashion.

*C. Limitation on Ex Parte Communications.*

The Second Proposed Rule contained a provision that banned *ex parte* communications between the auditor and the participating copyright owners, except in



certain narrow circumstances. For example, the auditor may communicate directly with the copyright owners if he or she has a reasonable basis to suspect fraud, and if the auditor reasonably believes that involving the licensee in the communication would prejudice the investigation of that fraud. In the Roundtable Notice the Office questioned whether this restriction is necessary and whether it might create inefficiencies. *See* 79 FR at 31994. At the roundtable the NCTA explained that this provision will promote transparency in the audit process. Specifically, the NCTA opined that it will ensure that copyright owners do not exercise undue influence over the auditor's deliberations, and that licensees are made aware of potential issues at the same time as the copyright owners, thus helping to eliminate the possibility of unfair surprise when the auditor delivers the initial draft of his or her report. Crunch Digital noted that this could be accomplished in most cases simply by copying the licensee on email communications between the auditor and the copyright owners or their representatives. The Office found the foregoing observations persuasive. Therefore, the Office has retained the prohibition against *ex parte* communications in the Third Proposed Rule.

*D. Certified List of Broadcast Signals.*

1. Comments.

The Second Proposed Rule provided that the licensee must deliver a document to the auditor and the copyright owners containing a certified list of the broadcast signals retransmitted during each accounting period that is subject to the audit, including the call sign for each broadcast signal and each multicast signal. In addition, cable operators must identify the classification of each signal on a community-by-community basis

pursuant to sections 201.17(e)(9)(iv)-(v) and 201.17(h) of the regulations. *See* 78 FR at 27141.

The Office added this requirement to the Second Proposed Rule at the request of the Joint Stakeholders. As the Office noted in the *Federal Register* document dated May 9, 2013, licensees are supposed to report this information in their SOAs and the person signing each SOA must certify that this information is true, correct, and complete. The Office sought comment on whether there is any benefit in requiring licensees to provide information that should be apparent from the face of an SOA. *See* 78 FR at 27141.

AT&T stated that “there is no need to include this ‘make-work’ step in the audit process,” because “it does not provide the auditor or the copyright owners with any information that is not readily available from the SOA.” AT&T Second Comment at 3. The ACA stated that “whatever benefit is derived, it is far outweighed by the administrative and financial burdens of compiling and submitting this information, especially for smaller cable operators.” ACA Second Comment at 3.

The Copyright Owners responded that this provision “provides tangible benefits that will promote the efficiency and effectiveness” of the audit procedure. CO Second Reply at 10. They noted that licensees that use Form SA 1-2, or the previous version of Form SA-3, are not required to identify “different channel line-ups linked to different subscriber groups.” *Id.* at 7. Therefore, “it is impossible to link communities with reported local stations” when reviewing these types of SOAs. *Id.* at 8.

Licensees that use the current version of Form SA-3 are supposed to identify the communities they serve, along with the relevant channel line-ups and subscriber groups. The Copyright Owners acknowledged that this information “might be sufficient to match

communities and stations for systems having one or two subscriber groups and one or two separate channel line-ups.” *Id.* at 8. But identifying the signals that are retransmitted in each community can be “difficult, if not impossible” for larger cable systems “that cover large geographic areas” with “multiple channel line-ups and numerous subscriber groups.” *Id.* at 7, 10. For example, the Copyright Owners noted that Comcast of Southeast PA LLC recently reported 589 communities, 30 channel line-ups with 7 to 49 stations each, and 46 subscriber groups, while Time Warner Northeast LLC recently reported 257 communities, 17 channel line-ups with 9 to 21 stations each, and 51 subscriber groups. *Id.* at 8. The Copyright Owners contended that it would be “cumbersome and costly” for the auditor to identify the distant and local signals that are retransmitted in each community, given the complexity of information reported in these types of SOAs. *Id.* at 10. By contrast, they contended that it would be easy for the licensee to compile this information, because “the cable system is more likely to know what stations that it carries in each community.” *Id.* at 10.

Requiring the licensee to provide this information at the beginning of the audit was “an important component of the Joint [Stakeholders’] Proposal” from the Copyright Owners’ point of view.<sup>19</sup> *Id.* at 7. The Joint Stakeholders agreed that the auditor should verify the information reported on the SOAs in order to confirm the correctness of the calculations and royalty payments reported therein, but the auditor should not determine whether a cable operator properly classified the broadcast signals reported on its SOAs, or whether a satellite carrier properly determined if any subscriber or group of

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<sup>19</sup> As noted in section I, the Joint Stakeholders’ proposal was submitted by the NCTA, DIRECTV, and the Copyright Owners identified in footnote five.

subscribers is eligible to receive any broadcast signals under the Act.<sup>20</sup> *See* 78 FR at 27151.

In their reply comments, the Copyright Owners explained that they agreed to narrow the scope of the auditor's inquiry on the condition that the licensee produces a certified list of broadcast signals that were retransmitted during the accounting period that is subject to the audit. CO Reply at 7-8. They contended that the auditor needs this information to confirm the correctness of the calculations and royalty payments reported in the licensee's SOAs. *Id.* at 7, 9. They also contended that the certified list will avoid the need for "costly, time-consuming litigation" over signal classification issues. *Id.* at 9-10. The Copyright Owners explained that the list will help them determine whether the licensee correctly classified the carriage of each signal. If they disagree with the licensee's classification, the Copyright Owners will be able to raise their concerns during the audit, which in turn will give the licensee an opportunity to amend its SOAs if it agrees that a mistake has been made. *Id.* at 9.

## 2. Discussion.

The Office has noted AT&T's and the ACA's concerns, but has concluded that the Copyright Owners have the better argument. Requiring the licensee to identify the broadcast signals that the licensee retransmitted and the communities that the licensee served provides the auditor with information he or she needs to interpret an SOA and to verify the calculations and royalty payments reported therein. It is also a fair trade-off for excluding the classification of signals as local/distant or permitted/non-permitted from the scope of the auditor's inquiry.

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<sup>20</sup> The Office included this suggested revision in both the Second Proposed Rule and the Third Proposed Rule. *See* 78 FR at 27151.

The Copyright Owners correctly noted that the previous version of Form SA-3 did not require licensees to report specific channel line-ups for each subscriber group. The current version of Form SA-3 instructs the licensee to identify each community served by the cable system and each television station carried by the cable system during the accounting period.<sup>21</sup> In the Office's experience, this information is clearly stated in the SOA in some cases, but in other cases it is not. When the information is deficient, the Office may write the licensee to request a clarification.<sup>22</sup>

Requiring the licensee to provide this information at the outset of the audit should not impose an undue burden on the licensee. The licensee should be familiar with the stations that it carries and the communities that it serves and thus should be able to prepare a list of stations and communities without difficulty. Moreover, the Third Proposed Rule provides that the licensee must retain any records needed to confirm the correctness of the calculations and royalty payments reported in its SOAs for at least three and a half years after the last day of the year that the SOA is filed with the Office, and if an SOA has been audited under this procedure, must continue to maintain those records until three years after the auditor delivers his or her final report. By definition, this would include records that identify the stations that the licensee carries and the communities it serves. Thus, even if the required information is not apparent from the face of the SOA, the licensee should be able to compile a list of stations and communities from its own records.

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<sup>21</sup> The Office issued the current version of Form SA-3 in April 2011. It may be used to prepare SOAs for accounting periods beginning on or after January 1, 2011.

<sup>22</sup> The fact that the Office does not communicate with the licensee does not necessarily mean that an SOA is clear or correct. The Office generally accepts the licensee's representations unless they are contradicted by information provided elsewhere in the SOA or in the Office's records or by information that is known to the Licensing Division.

The Office made one minor change to the Third Proposed Rule to make it consistent with the rules governing statements of account. Rather than employing the somewhat vague term “certified list,” the Third Proposed Rule clarifies that the list of broadcast signals must be signed by a duly authorized agent of the licensee, and that person must confirm that the facts contained in the document are true, complete, and correct to the best of his or her knowledge, information, and belief. *See* 37 CFR 201.11(e)(9)(iii)(E), 201.17(e)(14)(iii)(E).

#### **IV. Scope of the Audit.**

##### *A. Accounting Standard.*

The Second Proposed Rule provided that audits must be conducted “according to generally accepted auditing standards.” 78 FR at 27151. In the Roundtable Notice, the Office questioned whether this is the appropriate standard, noting that guidance from the American Institute of Certified Public Accountants (“AICPA”) indicates that “generally accepted auditing standards” are those used by accountants to audit corporate financial statements. *See* 79 FR at 31994. At the roundtable and in their Second Submission, the Joint Stakeholders were unable to reach agreement on what standard, if any, should be specified in lieu of “generally accepted auditing standards.” For its part, Crunch Digital confirmed at the roundtable that “generally accepted auditing standards” are not directly relevant to the type of audit contemplated by this rule. It also suggested that it is generally unnecessary to specify in advance the standard that will be applied during the audit, and that the auditor’s approach can be considered by the parties during the initial consultation.

Given the lack of consensus on this issue, and that none of the parties could explain why any particular auditing standard should apply to these proceedings, the Office believes it is unnecessary to specify the professional standard to be employed under the rule. Instead, the Office believes that it is appropriate to rely on the auditors themselves to adopt an appropriate audit methodology based on their professional judgment, and to review that methodology with the participating copyright owners and the licensee during the initial consultation described in section III.B.

*B. Subscriber Information.*

1. Comments.

Under the Second Proposed Rule the statutory licensee would be required to provide reasonable access to its books, records, or any other information that the auditor needs to conduct the audit. It also provided that the licensee should produce any other information that the auditor reasonably requests. *See* 78 FR at 27141-42.

AT&T asserted that a cable operator should not be required to produce information regarding individual subscribers, because this would impose an undue burden on the licensee. AT&T Second Comment at 4. Instead, AT&T argued that the licensee should be allowed to provide “reports that include the number of subscribers, the amount of revenue and the numbers of subscribers and revenues applicable to specific service offerings at the system level.” *Id.*

The Copyright Owners contended that AT&T is seeking “a special set of accounting standards” for cable operators. CO Second Reply at 6. In their view, “[a]uditors should be free to request whatever information they need to fulfill their responsibility,” and they stated that “ill-defined subscriber and revenue ‘information in

the form of reports” would not provide the participating copyright owners with the level of certainty that an audit should provide. *Id.* at 6-7.

2. Discussion.

The Office believes that it would be inappropriate to place categorical limits on the type of information that the auditor may request during an audit procedure. On the contrary, the auditor should be allowed to request any information he or she reasonably needs to conduct an audit. The Office is in no position to determine whether the auditor does or does not need individual subscriber information to satisfy applicable professional standards, and the Copyright Owners correctly note that the Office lacks the expertise that would be required to craft particularized exceptions to the information that reasonably could be called for in an audit.

The Office has considered AT&T’s comments, but has concluded that the proposed rule adequately addresses AT&T’s concerns. The Third Proposed Rule limits the number of SOAs and the number of cable systems that may be included in an initial audit or an expanded audit, which in turn limits the amount of information that the auditor may request. It provides that the auditor should be given “*reasonable* access” to the licensee’s books, records, and any other information that the auditor needs to conduct an audit (emphasis added). It provides that the licensee is only required to produce information that the auditor “*reasonably* requests” (emphasis added). It also provides that the audit must be conducted during regular business hours at a location designated by the licensee, that consideration should be “given to minimizing the costs and burdens associated with the audit,” and, if the parties agree, that the audit may be conducted in whole or in part by means of electronic communication.



As the Office stated in the *Federal Register* document dated May 9, 2013, cable operators receive a substantial benefit from the statutory licensing system, insofar as it provides a mechanism for licensing broadcast content without having to negotiate with the individual owners of that content. During the legislative process that led to the enactment of STELA, the Congressional Budget Office estimated that the cost of responding to an audit would be minimal, because the auditor would verify information that the licensee already collected and maintained as a condition for using the statutory license. *See* H.R. Rep. No. 111-319, at 20 (2009). While the cost of producing information needed to verify the calculations and royalty payments reported in an SOA may be a new obligation, it is a reasonable cost of doing business under the statutory licensing system. *See* 78 FR at 27148.

*C. Suspension of the Audit.*

1. Comments.

The Second Proposed Rule provided that statutory licensees could suspend an audit for up to thirty days before the semi-annual deadlines for filing an SOA, although licensees could not exercise this option after the auditor issues the initial draft of his or her report. *See* 78 FR at 27141. The NCTA strongly disagreed with this aspect of the Second Proposed Rule. NCTA Second Reply at 6. It contended that a licensee should be allowed to suspend an audit for up to sixty days before the filing deadlines, because “the same individuals that will be involved in responding to an audit . . . typically will be responsible for preparing new statements of account for that licensee.” *Id.* at 5. AT&T expressed similar concerns in its comments on the First Proposed Rule, explaining that the staff members who would be responsible for responding to an audit would be the

same individuals who are responsible for preparing AT&T's SOAs. AT&T First Comment at 1. AT&T explained that preparing these SOAs "essentially occupies the full time of the staff from two weeks before the close of each semi-annual period through the due date for the [SOA], two months after the close of the period." *Id.*

2. Discussion.

The Office believes it would be unduly restrictive to prevent the auditor from working for up to four months out of the year, given the limit on the number of audits that may be conducted each year. However, the Office recognizes that the same individuals may be responsible for preparing the licensee's SOAs, responding to the auditor's requests for information, and reviewing the conclusions set forth in the auditor's report, and that it is difficult to predict how much time or effort this may require.

The Third Proposed Rule balances these interests by allowing the licensee to suspend its participation in the audit for up to sixty days before the semi-annual deadlines for filing an SOA (regardless of whether the licensee is subject to an initial audit or an expanded audit, and regardless of whether the auditor has issued the initial draft of his or her report). However, there are two exceptions to this rule. If the participating copyright owners provide the licensee with a list of prospective auditors, then, as discussed in section III.A, the licensee will be required to select one of those individuals within five business days thereafter, even if the licensee has suspended its participation in the audit. Likewise, the licensee will be required to provide the participating copyright owners with the list of broadcast signals discussed in section III.D, and a representative of the licensee will be required to participate in the initial consultation discussed in section III.B. These pre-examination activities should not impose an undue burden on the licensee. Moreover,

under the proposed schedule for conducting an initial audit involving a cable operator, these preliminary activities may need to take place at the same time that the licensee is preparing its statement of account for the second accounting period of the previous year.<sup>23</sup> If the licensee could postpone these initial activities until after the filing of its SOA, it could prevent the auditor from completing his or her review in a timely manner.

While the Third Proposed rule allows the licensee to suspend its participation in the audit, it does not prevent the auditor from continuing to work on the audit during the suspension. For example, the auditor could review information he or she has received from the licensee and formulate requests for additional information, but the licensee would not be required to respond to those follow-up requests until the suspension ended. Since the SOA deadlines are known in advance, the parties are strongly encouraged to discuss these issues during the initial consultation that is contemplated under the Third Proposed Rule. If the licensee intends to suspend its obligations under this provision, the auditor should schedule the delivery of critical information that might otherwise threaten the audit deadline well in advance of the suspension period.

## **V. Draft Audit Report and Final Audit Reports.**

### *A. Thirty Day Consultation Period.*

The Second Proposed Rule provided that the auditor should prepare a written report setting forth his or her initial conclusions and should deliver the initial findings to the licensee (but not the copyright owners). It provided that the auditor should then consult with the licensee for a period of thirty days, and if the auditor agreed that there were errors in the report, the auditor should correct those errors before delivering a final

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<sup>23</sup> Cable companies must file SOAs covering the second half of the preceding calendar year by March 1st. 37 CFR 201.17(c)(1). Satellite companies must file SOAs for this period by January 30th. 37 CFR 201.11(c)(1)).

report to the participating copyright owners. If the auditor and the licensee were unable to resolve their differences, then under the Second Proposed Rule, the licensee could prepare a written rebuttal within fourteen days after the thirty-day consultation period, which would be attached as an exhibit to the final report.

In the Roundtable Notice, the Office asked the parties to consider whether the auditor and the licensee should be given more flexibility with respect to the consultation phase of the audit. In particular, the Office wanted to know whether the licensee should be given an opportunity to review the auditor's initial findings before the consultation period begins, whether a thirty-day consultation period would be a sufficient amount of time to resolve potential differences between the auditor and the licensee, whether the auditor should provide the licensee with a revised version of the report at the end of the consultation period (*i.e.*, before the licensee submits its written rebuttal), whether the licensee should be given more than fourteen days to prepare a rebuttal, or whether the auditor should be given more than five days to prepare the final report after receiving the licensee's rebuttal. *See* 79 FR at 31994.

At the roundtable, the NCTA stated that thirty days is a sufficient amount of time for the consultation period and that licensees do not need to receive an initial draft of the auditor's report in advance of the consultation period or an updated draft at the conclusion of that period. In the NCTA's view, adding any additional time to the calendar would merely delay the audit process. The NCTA stated that the written rebuttal will focus solely on the issues that the auditor and the licensee were unable to resolve during the consultation period (if any), and that fourteen days is a sufficient amount of time to prepare that response. If the licensee cannot convince the auditor to

change his or her conclusions during the consultation period, then, in the NCTA's view, it is unlikely that the auditor will be persuaded by anything that the licensee says in its rebuttal and unlikely that the auditor will make any changes or revisions to the final version of that report before it is delivered to the participating copyright owners. The NCTA suggested that the rebuttal essentially would be a "minority report" and the act of attaching the rebuttal to the final report would be a ministerial task without any immediate practical significance. Thus, the auditor should not need any additional time to review the rebuttal or prepare the final report for the participating copyright owners.

In adjusting the proposed rule, the Office has largely relied upon the NCTA's understanding of how the consultation process would operate. Under the Third Proposed Rule, the auditor will deliver an initial draft of his or her report to the licensee (but, absent a suspicion of fraud, not to the participating copyright owners). The delivery of the initial draft will mark the beginning of the thirty-day consultation period. If, after consulting with the licensee, the auditor agrees that there are errors in the initial draft, the auditor is required to correct those errors. The auditor will then prepare a written report setting forth his or her ultimate conclusions, and on the last day of the consultation period will deliver the final version of that report to the licensee (but not to the participating copyright owners, again absent a suspicion of fraud).

Although the Office accepted most of the NCTA's suggestions, the Office believes it would be helpful if the auditor provides the licensee with the final version of the audit report at the end of the consultation period. This will create a clear record of any changes that the auditor made based on his or her discussions with the licensee, and

if the licensee decides to prepare a written rebuttal, it will make it easier for the licensee to identify and respond to any issues that remain in dispute.

Upon receiving the final version of the report, the licensee may provide a written rebuttal within fourteen days after the conclusion of the thirty-day consultation period, but is not required to do so. Consistent with the NCTA's recommendation, the auditor will simply attach any rebuttal received from the licensee to the final version of his or her report, which together will constitute the final report. The auditor will not otherwise address the issues raised in the rebuttal; the rebuttal will serve merely to capture the ultimate areas of disagreement between the auditor and the licensee for the benefit of the participating copyright owners – since they may not be privy to the issues discussed during the consultation period – and to memorialize the licensee's position in the event that the licensee and the participating copyright owners revisit these issues in follow-on negotiations or litigation.

Within five business days after the written rebuttal has been delivered to the auditor or, if no rebuttal is provided, after the fourteen-day deadline for providing a rebuttal has passed, the auditor will deliver a complete copy of the final report to the participating copyright owners, with a copy to the licensee. As discussed in section II, the Third Proposed Rule further provides that the final report must be delivered by November 1st of the year in which the notice of intent to audit was published in the *Federal Register* (except that, as noted above, this requirement would not apply in the case of an expanded audit).

*B. Suspicion of Fraud.*

1. Comments.

As discussed in section V.A, the Second Proposed Rule provided that the auditor must deliver the initial draft of his or her report to the licensee (but not the participating copyright owners) at the beginning of the consultation period. However, the Second Proposed Rule provided that the auditor could also send the initial draft to the participating copyright owners if the auditor reasonably suspected that the licensee had committed fraud. In such a case, the Second Proposed Rule provided that the auditor could send the licensee an abridged version of the initial draft containing all of the auditor's initial findings except for the auditor's suspicion of fraud. Consistent with certain other regulatory audit provisions,<sup>24</sup> the Office wanted to address the possibility that if an auditor discloses his or her suspicions to a licensee, the licensee may be tempted to conceal or destroy incriminating evidence before copyright owners are able to take action. *See* 78 FR at 27145.

The NCTA objected to this approach. It contended (incorrectly) that there is “no precedent in the Office’s other audit rules” for withholding a suspicion of fraud from the licensee. NCTA Second Reply at 3. The NCTA predicted that the auditor “likely will lack formal legal training” and contended that “the Office’s rules or precedent” do not provide “any guidance as to what types of actions might be considered ‘fraud’ in this context.” *Id.* at 3. Instead, the NCTA stated that the auditor should be allowed to discuss his or her suspicions with the copyright owners “while still giving licensees an opportunity to respond to those allegations prior to the issuance of a final report.” *Id.* at 3.

## 2. Discussion.

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<sup>24</sup> *See* 37 CFR 261.6(f), 261.7(f), 262.6(f), 262.7(f) (SOAs for ephemeral recordings and digital performance of sound recordings).

As referenced above, the fraud exception set forth in the Second Proposed Rule was based, in part, on similar regulations that the Office has adopted in the past. *See* 37 CFR 261.6(f), 261.7(f), 262.6(f), 262.7(f). However, the NCTA is correct that the statutory provisions governing cable audits expressly state that the Register “shall issue regulations” that “shall . . . require” the “auditor to review [his or her] conclusions” with the licensee and “shall . . . provide an opportunity to remedy any disputed facts or conclusions.” 17 U.S.C. 111(d)(6)(C)(i), (iii).

After weighing the NCTA’s concerns, the Office has concluded that the licensee should be given an opportunity to review and respond to the auditor’s entire report, even in cases where the auditor suspects fraud. As noted in Section IX, licensees will be required to retain any records needed to confirm the correctness of the calculations and royalty payments reported in their SOAs for three and a half years after the last day of the year in which the SOA is filed with the Office, and if an SOA is audited under this procedure, to continue to maintain those records until three years after the auditor delivers his or her final report to the copyright owners. The risk that the licensee may conceal or destroy incriminating evidence should be minimized if the auditor preserves copies of that evidence before disclosing his or her suspicions to the licensee. If the auditor has a reasonable basis for suspecting fraud during the initial phase of the audit (*i.e.*, before the auditor prepares the initial draft of his or her report and before the consultation period begins), then, as discussed in section III.C, the auditor may communicate privately with the participating copyright owners, provided that the auditor reasonably believes that involving the licensee in the communication could prejudice further investigation of the fraud. As an additional protective measure, the Third



Proposed Rule provides that the auditor may share the initial draft of his or her report with both the participating copyright owners and the licensee during the consultation period in cases where the auditor suspects fraud.

## **VI. Corrections, Supplemental Royalty Payments, and Refunds.**

Congress directed the Office to “establish a mechanism for the [licensee] to remedy any errors identified in the auditor’s report and to cure any underpayment identified.” 17 U.S.C. 111(d)(6)C(ii). If the information in an SOA is incorrect or incomplete, if the calculation of the royalty fee is incorrect, or if the licensee has failed to deposit the correct amount of royalties, the Second Proposed Rule provided that the licensee may correct those errors by following the procedures set forth in 37 CFR 201.11(h)(1) or 201.17(m)(3). *See* 78 FR at 27145.

The Third Proposed Rule modifies this aspect of the audit procedure in three respects. First, it clarifies that the licensee may cure an underpayment by depositing additional royalties with the Office, but may not deliver those payments directly to the participating copyright owners or their representatives. Second, it provides that the licensee may cure deficiencies identified in the auditor’s report only if the licensee represents that it has reimbursed the participating copyright owners for its share of the audit costs if reimbursement is owed. Third, it allows the licensee to request a refund from the Office if the auditor discovers an overpayment on any of the SOAs at issue in the audit.

### *A. Supplemental Royalty Payments Must Be Deposited With the Office.*

The statute clearly indicates that copyright owners should be given a single opportunity to audit a particular SOA, and that the auditor should review that statement

on behalf of all copyright owners, regardless of whether they participate in the audit or not. *See* 77 FR at 35647. The statute also indicates that any copyright owner should be allowed to claim an appropriate share of additional royalty fees that result from the audit, even if that copyright owner did not join the audit or pay for the auditor's services. *Id.* at 35649.

Consistent with these principles, the Third Proposed Rule provides that a licensee may cure the underpayments identified in the auditor's final report only by depositing the additional royalties due under the statutory license with the Office. Paying additional royalties directly to the participating copyright owners pursuant to a negotiated settlement agreement would not satisfy this requirement, because that would unfairly prevent non-participating copyright owners from claiming an appropriate share of those payments. In the interests of transparency, the Third Proposed Rule provides that a representative of the participating copyright owners is to promptly notify the Office if the auditor discovered an underpayment or overpayment on any of the statements that were reviewed during the audit (although the copyright owners do not need to disclose the specific amounts). This will create a public record for the benefit of copyright owners that did not participate in the audit process, and will inform the Office that supplemental royalty payments, amended statements, and/or refund requests may be forthcoming from the licensee.

*B. Reimbursement of Costs.*

The Office previously determined that it has the authority to include a cost-shifting provision in the regulation, and the Second Proposed Rule expressly provided that the licensee "shall pay" for a portion of the audit costs if the auditor discovers a net

aggregate underpayment that exceeds certain thresholds. *See* 78 FR at 27152. But as the ACA noted at the roundtable, some licensees may refuse to reimburse the participating copyright owners if they believe that the auditor's conclusions are unjustified. And as discussed in section VIII.C.2, Congress did not create a specific cause of action for licensees that fail to reimburse the copyright owners for their share of the audit costs.

The Third Proposed Rule addresses this issue by providing that a licensee may exercise its right to address deficiencies identified in an auditor's report only if the licensee confirms that it has reimbursed the participating copyright owners for any audit costs that the licensee is required to pay. In other words, the Office will not accept an amended SOA seeking to cure deficiencies discovered in an audit unless the licensee confirms in writing that it has reimbursed the participating copyright owners for its share of the audit costs or that it has no obligation to do so under the cost-shifting or cost-splitting rule.

The Second Proposed Rule provided that an amended SOA and/or additional royalty payments must be received within sixty days after the delivery of the final report to the participating copyright owners and the licensee, or within ninety days in the case of an audit involving an MSO.<sup>25</sup> In their Second Submission, the Joint Stakeholders stated that the licensee should reimburse the participating copyright owners for its share of the audit costs (if any) within thirty days after these deadlines. The Office agrees that the licensee should be given a precise deadline for reimbursing the participating copyright owners, but because a licensee's ability to cure its SOAs may be contingent upon paying its share of the audit costs, the Third Proposed Rule provides that the deadline for

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<sup>25</sup> None of the parties objected to these deadlines.

reimbursing the participating copyright owners and the deadline for filing an amended SOA and/or depositing additional royalties will be the same.

*C. Refunds.*

If the auditor discovers an overpayment on a particular SOA, the statutory licensee may request a refund by following the procedures set forth in sections 201.17(m) or 201.11(h) of the Office's existing regulations. The Second Proposed Rule provided that the refund request must be received in the Office within thirty days after the auditor delivers his or her final report to the licensee. The NCTA suggested that a licensee should be given sixty days to submit a refund request. NCTA Second Reply at 5. The Office has accepted the NCTA's suggestion, because it would be consistent with the sixty-day deadline for submitting supplementary royalty payments under the Third Proposed Rule, and consistent with the sixty-day deadline for requesting refunds under section 201.17(m) of the Office's existing regulations. In addition, the Third Proposed Rule corrects certain numbering errors in section 201.17(m) that were inadvertently created when the Office added a new paragraph to that section of the regulations. *See* 78 FR 1755 (Jan. 11, 2013).

**VII. Expanded Audits.**

Under the Second Proposed Rule, copyright owners would be allowed to conduct an initial audit of no more than two SOAs in a proceeding involving a satellite carrier or a single cable system. In a proceeding involving an MSO, copyright owners would be allowed to audit no more than ten percent of the Form 2 and Form 3 systems owned by that MSO. *See* 78 FR at 27143. To protect the interests of copyright owners, the Second Proposed Rule also created an exception to these rules. If the auditor discovered a net

aggregate underpayment in his or her review of a satellite carrier or a single cable system, the copyright owners would be allowed to audit previous SOAs filed by that cable system or satellite carrier, so long as they filed a notice of intent to audit those statements in a timely manner. Likewise, if the auditor discovered a net aggregate underpayment in his or her review of an MSO, the copyright owners would be allowed to audit previous statements filed by each of the systems subject to the initial audit, and in the following calendar year they would also be allowed to audit a larger sample of the cable systems owned by that MSO. *See id.* The Third Proposed Rule modifies this portion of the audit procedure in several respects.

*A. Procedure for Conducting an Expanded Audit.*

As discussed in section II, the Third Proposed Rule provides that the copyright owners must file a notice of intent to conduct an expanded audit, the notice must specify the statements that will be included in the expanded audit, and the notice must be received within three years after the last day of the year in which those statements were filed. It further provides that the expanded audit should be conducted using the same procedures that applied to the initial audit, although there are two exceptions to this rule. First, a notice of intent to conduct an expanded audit may be filed during any month of the year, as long as the copyright owners comply with the time limits set forth in section 111(d)(6)(E) of the Act; and second, the auditor does not need to deliver his or her final report by November 1st of the year in which the notice was published in the *Federal Register*.

*B. An Expanded Audit May Be Conducted Concurrently With an Initial Audit.*

Under the Third Proposed Rule, an expanded audit of a single cable system, multiple cable systems owned by the same MSO, or a satellite carrier may be conducted concurrently with another audit involving that same licensee. Since the initial audit may not be completed until late in the year and since the expanded audit may involve multiple SOAs and/or multiple cable systems, it seems unlikely – if not impossible – that the auditor would be able to complete the initial audit and the expanded audit within the same calendar year.

If the auditor discovers an underpayment of five percent or more during an initial audit, the Office believes that the copyright owners should be allowed to review previous statements filed by that licensee and to promptly initiate a new audit of the licensee's more recent statements. Likewise, if the auditor discovers an underpayment in the case of an MSO, then, as contemplated by the Second Proposed Rule, the copyright owners should be allowed to audit a larger sample of the MSO's cable systems in the following calendar year, even if an expanded audit remains pending. Copyright owners are entitled to know if the same problems appear in the licensee's earlier or later filings, or more broadly throughout an MSO's systems. If the expanded audit displaced the copyright owners' ability to initiate a new audit, it could impede the copyright owners' ability to audit the licensee's more recent filings, particularly because an expanded audit may be noticed at any time and has no deadline for completion. It would seem unwarranted to constrain the copyright owners' ongoing audit right vis-à-vis a particular licensee where that licensee has been found to have underpaid royalty fees in the past.

*C. The Initial Audit and the Expanded Audit May Be Conducted by the Same Auditor.*

The Third Proposed Rule provides that the expanded audit may be conducted by the same auditor that conducted the initial audit of that licensee. The NCTA contended that the Second Proposed Rule created a procedure for selecting an auditor for an expanded audit involving a satellite carrier or a single cable system, but “[t]here is no provision made for the selection of an auditor for an expanded MSO audit.” NCTA Second Reply at 7. That is incorrect. The Second Proposed Rule provided that if the auditor discovered a net aggregate underpayment on the statements at issue in an audit involving an MSO, “[t]he 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*” (emphasis added). 78 FR at 27153. In other words, the procedure for selecting an auditor for an expanded audit involving a cable operator that owns multiple cable systems would be the same as the procedure for an expanded audit involving a cable operator that owns a single cable system.

To eliminate further confusion, the Third Proposed Rule clarifies that if the auditor discovers a net aggregate underpayment on the statements at issue in an initial audit involving an MSO, the cable systems that were included within that initial audit may be subject to an expanded audit. It also clarifies that the MSO may be subject to an initial audit involving a larger sample of its cable systems in the following calendar year, provided that the copyright owners file a notice of intent to audit those systems in a timely manner (*i.e.*, in the month of December of the year in which the auditor delivered the final report that triggered the option of auditing a larger sample).

The NCTA also contended that copyright owners should not be allowed to unilaterally use the same auditor in two consecutive expanded audits involving an

MSO.<sup>26</sup> NCTA Second Reply at 8. Instead, the MSO should select the auditor “from a slate of names supplied by the [copyright] owners that could include the same auditor that conducted the initial audit.” *Id.* at 7.

As noted in section III.A, the Second Proposed Rule provided that the licensee could select the auditor from a list of names provided by the copyright owners. Because an expanded audit is simply an extension of the initial audit, it is appropriate and efficient for the same individual to conduct the audit from start to finish. Under the Second Proposed Rule, the same auditor who conducted the initial audit could conduct the expanded 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. If the auditor is no longer qualified or independent, or if the copyright owners prefer to use a different individual, a new auditor could be selected using the procedure discussed in section III.A.

In its comments, the NCTA recognized that there are benefits to using the same auditor to conduct an initial audit and an expanded audit. The auditor will be familiar with the licensee’s accounting systems and methodologies, which should improve the efficiency of the expanded audit and reduce the potential burden on the licensee. The NCTA contended that these benefits should be balanced against the “benefits of giving the [MSO] a new opportunity to have a say in the selection of the auditor.” *Id.* at 8. However, the NCTA failed to explain what these purported benefits might be, why they should be bestowed upon MSOs (but denied to satellite carriers or cable operators that

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<sup>26</sup> The Joint Stakeholders made a similar suggestion in their First Submission. The NCTA correctly notes that the Office did not include this suggestion in the Second Proposed Rule because it “fail[ed] to see the justification for this limitation.” *See* 78 FR 27143 n.19; NCTA Second Reply at 7-8.



own a single cable system), or why they outweigh the benefits of using the same individual to conduct the initial audit and the expanded audit.

## **VIII. Cost of the Audit Procedure.**

### *A. Allocation of Costs.*

#### 1. Comments.

Building off a proposal made by the Joint Stakeholders, the Second Proposed Rule provided that the participating copyright owners would be required to pay the auditor for his or her services if the auditor discovered an overpayment on the SOAs at issue in the audit, or if the auditor discovered a net aggregate underpayment of ten percent or less of the amount reported on those statements. If the auditor discovered a net aggregate underpayment of more than ten percent on the SOAs at issue in the audit, the statutory licensee would be required to reimburse the copyright owners for those costs.

In addition, the Second Proposed Rule included a provision for splitting these fees in certain circumstances. If the auditor concluded in his or her final report that there was a net aggregate underpayment of more than ten percent, the cost of the audit would be split evenly between the copyright owners and the licensee if the licensee prepared a written rebuttal explaining the basis for its good faith belief that the net aggregate underpayment was between five percent and ten percent of the amount reported on the SOAs.<sup>27</sup> *See* 78 FR at 27152.

In all cases, there would be an overall limit on the costs that the licensee would be expected to pay. Specifically, the licensee would not be required to pay for any costs that

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<sup>27</sup> If the licensee failed to provide a written rebuttal in this situation, then as discussed in the preceding paragraph, the licensee would be required to reimburse the copyright owners for the cost of the audit procedure.

exceeded the amount of the net aggregate underpayment that the auditor identified in his or her final report. *See* 78 FR at 27148.

In comments received in response to the Second Proposed Rule, the ACA asked the Office to go a step further by making it clear that if the auditor discovers a net aggregate underpayment of ten percent or more the licensee should not have to pay for any portion of the audit costs if the licensee prepares a written rebuttal stating that the underpayment was five percent or less and explaining the basis for its belief. ACA Second Comment at 4.

In the Roundtable Notice, the Office questioned whether the costs should be split between the parties based merely on the views expressed in the licensee's rebuttal. As the NCTA indicated during the roundtable, it is unlikely that the auditor will change his or her mind based on anything said in the rebuttal. If that is the case, it is unclear why a licensee's objections should gain renewed significance for the purpose of allocating costs, when those objections presumably were considered and rejected by the auditor during the consultation period. *See* 79 FR at 31995.

Following the roundtable, the Joint Stakeholders provided a substitute recommendation in their Second Submission. Under that proposal, the copyright owners would bear the costs of the audit if the auditor concluded in the final report that there was an overpayment or a net aggregate underpayment of five percent or less, and that the licensee would bear the costs if the auditor concluded that there was a net aggregate underpayment of ten percent or more. In cases falling in between, where the auditor found a net aggregate payment of more than five percent but less than ten percent, the

audit costs would be split evenly between the licensee on the one hand and the participating copyright owners on the other.

## 2. Discussion.

The Office concurs with the cost-shifting and cost-splitting proposals set forth in the Joint Stakeholders' Second Submission. The Office does not accept the ACA's proposal, which would allow a licensee to avoid paying any portion of the audit costs simply by offering its views as to why an underpayment was five percent or less (even if the auditor determined that the underpayment was ten percent or more). ACA Second Comment at 4. As the Office noted in its Roundtable Notice, it is unclear why the licensee's rebuttal should be given greater weight than the auditor's conclusions, particularly given the NCTA's observation that the auditor would not be expected to make any changes to the final report based on the views expressed in the rebuttal.

The ACA contended that the proposed rule "may impose an unfair burden on small cable operators" by requiring them to pay for the cost of the audit "if the auditor finds a net aggregate underpayment of less than five percent." *Id.* at 3. But as discussed above, the licensee would not be required to pay for any portion of the audit costs in this situation. The ACA does not contend that it would be unfairly burdensome for small cable operators to pay for the cost of an audit when the underpayment exceeds ten percent. Indeed, the ACA acknowledged that small cable operators will largely be protected by the provision stating that licensees will not be required to pay for any costs that exceed the amount of the underpayment that the auditor identifies in his or her final report. *Id.* at 2. The Office's existing regulations provide additional limitations for small cable operators that use Form SA 1-2. There is an upper limit on the gross receipts that

may be reported on this form, which limits the amount of any underpayment that could be discovered during the course of an audit, which in turn limits the amount of any cost-shifting or cost-splitting that could be required. *See* 37 CFR 201.17(d)(2)(i). As the MPAA observed at the roundtable, it seems unlikely that copyright owners will be inclined to audit small cable operators, because even if the auditor discovers an underpayment, the cost of conducting the audit may exceed any amount that could conceivably be recovered from the licensee.

*B. Monthly Invoices.*

1. Comments.

The Second Proposed Rule provided that the copyright owners should deliver an itemized statement to the licensee at the conclusion of the audit specifying the total cost of the audit procedure. *See* 78 FR at 27149. The Joint Stakeholders disagreed with this aspect of the Second Proposed Rule. In both their first and second proposals, they suggested that the auditor should be required to provide the licensee with itemized invoices during the course of the audit and that these invoices should be delivered by the fifteenth of each month. 78 FR at 27149; JS Second Submission at 2. The NCTA explained that this would minimize surprises for the licensee, and noted that monthly statements are a common feature of audits involving private sector program carriage agreements. NCTA Second Reply at 6-7.

2. Discussion.

After further analysis, the Office has included the Joint Stakeholders' suggestion in the Third Proposed Rule. The House Committee stated that the Office "may consider . . . audit provisions in private agreements to which cable operators or content

owners may be parties.” H.R. Rep. No. 111-319 at 9 (2009). A monthly reporting requirement would promote transparency by requiring the auditor to disclose the ongoing cost of the audit procedure. And this would provide copyright owners and licensees with advance notice in the event that the auditor discovers an underpayment that triggers the cost-shifting or cost-splitting mechanisms discussed in section VIII.A above.

*C. Enforcement of Cost-Shifting Provision.*

1. Comments.

Under the Second Proposed Rule, if the auditor discovered a net aggregate underpayment that triggered the licensee’s obligation to pay all or part of the cost of the audit, the licensee would be required to make such a reimbursement within a specified period of time. If the licensee disagreed with the auditor’s conclusions, however, the rule provided the licensee with a mechanism for recouping those costs from the participating copyright owners, so long as a court issued a final judgment finding that the net aggregate underpayment was ten percent or less. *See* 78 FR at 27149. In proposing that provision, the Office assumed that the licensee might seek a declaratory judgment of non-infringement, and as part of that proceeding, obtain a judgment from a court evaluating the correctness of the conclusions set forth in the audit report. *Id.*

In response to the Second Proposed Rule, AT&T objected to any provision that would affirmatively obligate licensees to pay the costs of the audit.<sup>28</sup> It stated that “the enforcement mechanism built into the statutory license” allows copyright owners to seek “recourse through the courts if they believe that the licensee has failed to fulfill its

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<sup>28</sup> AT&T also contended that the Office does not have the authority to include a cost-shifting provision in this audit regulation. AT&T Second Comment at 1-2. AT&T made the same argument in the initial phase of this rulemaking. AT&T First Comment at 5-8. The Office addressed that argument in its *Federal Register* document dated May 9, 2013, concluding that it does have such authority. *See* 78 FR at 27146-48.

obligations under the statute and the rules.” AT&T Second Comment at 2. AT&T contended that the Second Proposed Rule stands this “fundamental premise” on its head, because it “shifts the enforcement obligation from the copyright owners to the licensee” to seek reimbursement of costs. *Id.* at 2. It also contended that this would be “an unwieldy and potentially costly process,” because “the licensee would be forced to seek reimbursement from numerous sources” if the copyright owners divide the payment among themselves. *Id.* at 2.

The ACA expressed the same view in its reply comments. It contended that it would be “burdensome and unfair” to expect small cable operators to pay for the audit and then take legal action to recover those costs from the copyright owners. The ACA explained that small cable operators have fewer financial and legal resources than the copyright owners, and stated that the cost of bringing a declaratory judgment action may exceed the amount that the licensee could expect to recover. ACA Second Reply at 2-4.

The Copyright Owners noted that AT&T made a similar argument during an earlier phase of this rulemaking,<sup>29</sup> and that AT&T’s latest argument is simply a variation on the same theme. CO Second Reply at 2-3. They also stated that the licensee “will have no trouble” identifying the relevant copyright owners if there is a dispute between the parties. *Id.* at 5. They noted that the copyright owners will be required to identify themselves at the beginning of the audit by filing a notice with the Office. In the event that the court rules in the licensee’s favor, they stated that the copyright owners will “likely” be subject to an order directing them to reimburse the licensee. *Id.* at 5.

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<sup>29</sup> The Office addressed this argument in its *Federal Register* document dated May 9, 2013. See 78 FR at 27149.

The Office expressed several concerns about this provision in the Roundtable Notice and during the roundtable discussion. *See* 79 FR at 31995. In particular, the Office questioned whether the parties expect to engage in the sort of litigation contemplated by the Second Proposed Rule, the gravamen of which would seemingly be an infringement action or a declaratory judgment action for non-infringement; whether the court would review the auditor's report to determine the exact amount of underpayment in any such litigation; and whether the issue of audit costs might be better understood as a potential element of actual damages in such an infringement suit. The Office expressed reservations about its authority to essentially dictate the issues that a federal district court would be required to address in a suit initiated after the completion of the audit. In addition, the Office questioned whether the rule should affirmatively require the licensee to pay for the audit costs.

In their Second Submission, the Joint Stakeholders reiterated their belief that the proposed rule should provide a method for licensees to recover the costs of the audit from the participating copyright owners in a judicial proceeding. Specifically, they urged the Office to include the following provision in the proposed rule:

In the event the statutory licensee disputes the amount of the net aggregate underpayment identified by the auditor, and an action is brought in a court of competent jurisdiction to determine the royalties due for the period(s) covered by the auditor's final report, there shall be a final true-up of the amount of the auditor's costs borne by either party based on the final outcome of that action relative to the cost responsibilities set forth herein.

JS Second Submission at 2.

## 2. Discussion.

As AT&T and the ACA correctly observed, under the Second Proposed Rule, the licensee would have had an absolute obligation to reimburse the copyright owners for the

cost of the audit, even if the licensee disagreed with the auditors' conclusions and declined to submit any additional royalty payments to the Office. AT&T Second Comment at 2; ACA Second Reply at 2-3. The Third Proposed Rule modifies the Second Proposed Rule so that licensees are required to pay the costs of the audit if they wish to cure a deficiency, as explained in section VI.B above. This revised approach has several advantages. Although the Second Proposed Rule directed the licensee to pay for the audit costs, it provided no obvious mechanism for the Office or any other party to enforce that mandate. Tying the payment of audit costs to the cure provisions, by contrast, will give the licensee an incentive to make these payments. If the licensee disagrees with the auditor's conclusion regarding the royalty underpayment, the licensee may choose not to deposit additional royalties with the Office or pay the attendant audit costs. In the case where a licensee opts not to cure, the licensee will run the risk of being subject to an infringement action, or in the alternative, could bring its own action against one or more of the copyright owners seeking a declaratory judgment of non-infringement.

The Office believes it is unnecessary for the rule to require a "true-up" of the auditor's costs after the close of any follow-on litigation, as the Joint Commenters urged in their Second Submission. To begin with, it is unclear what the term "true-up" is intended to mean or how the Joint Stakeholders propose to enforce this regulatory obligation. Moreover, the Joint Stakeholders' proposal raises issues that can and should be resolved by a court in the exercise of its remedial discretion as part of the contemplated judicial proceeding. In this regard, the Office notes that the audit costs might be characterized as an element of actual damages incurred by the copyright owners, or as an element of the relief to be awarded in a declaratory judgment action. *See* 28



U.S.C. 2202 (authorizing courts to grant “[f]urther necessary or proper relief based on a declaratory judgment or decree . . . against any adverse party whose rights have been determined by such judgment”).

## **IX. Retention of Records.**

### *A. Comments.*

The Second Proposed Rule provided that a statutory licensee should retain any records needed to confirm the correctness of the calculations and royalty payments reported in an SOA or amended SOA for three and a half years after the last day of the year that the SOA or amendment was filed with the Office, or in the event that an SOA or amended SOA was the subject of an audit, for three years after the auditor delivered his or her final report to the parties. As the Office explained in its earlier *Federal Register* document dated June 14, 2012, it is important to ensure that licensees “retain their records until the deadline for auditing [an SOA] has passed.” 77 FR at 35647. The Office is also concerned that copyright owners have the benefit of the three-year statute of limitations provided in the Act when an audit takes place. *See* 17 U.S.C. 507(b).

The NCTA contended that the Second Proposed Rule contemplates “a very lengthy, and burdensome, record retention period” following the completion of the audit and that it “imposes a significant burden” on small cable operators as well as MSOs that file multiple SOAs in each accounting period. NCTA Second Reply at 4. The NCTA instead suggested that a licensee be required to retain the required records for no more than one year after the auditor issues his or her final report.

### *B. Discussion.*

The Office has considered the NCTA’s concerns but has concluded that a licensee should be required to retain relevant records during the pendency of an audit and for three years after the auditor issues his or her final report, as provided in the Third Proposed Rule. This will ensure that the licensee does not discard its records before the three-year statute of limitations may expire. Moreover, the burden of retaining such records should be minimal. Many licensees collect, report, and maintain their records in electronic form, which should limit the cost of complying with the proposed rule. The Third Proposed Rule limits the number of SOAs that may be included in each audit, which in turn limits the number of records that must be retained when the auditor issues his or her final report. Furthermore, the licensee is only required to keep records that are “*necessary* to confirm the correctness of the calculations and royalty payments reported” in those SOAs.

#### **List of Subjects in 37 CFR Part 201**

Copyright, General Provisions.

#### **Proposed Regulations**

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

#### **PART 201—GENERAL PROVISIONS**

1. Amend the authority citation for part 201 to read as follows:

**Authority:** 17 U.S.C. 702.

Section 201.10 also issued under 17 U.S.C. 304.

Section 201.16 also issued under 17 U.S.C. 111(d)(6) and 17 U.S.C.

119(b)(2).

2. Revise § 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 procedures pertaining to the verification of a Statement of Account and royalty fees filed with the Copyright Office pursuant to sections 111(d)(1) or 119(b)(1) of title 17 of the United States Code.

(b) *Definitions.* As used in this section:

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

(2) *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.

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

(4) *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.

(5) *Participating copyright owner* means a copyright owner that filed a notice of intent to audit a Statement of Account pursuant to paragraph (c)(1) or (2) of this section and any other copyright owner that has given notice of its intent to participate in such audit pursuant to paragraph (c)(3) of this section.

(6) The term *satellite carrier* has the meaning set forth in 17 U.S.C. 119(d)(6).

(7) The term *secondary transmission* has the meaning set forth in 17 U.S.C. 111(f)(2).

(8) *Statement of Account* or *Statement* means a semiannual Statement of Account filed with the Copyright Office under 17 U.S.C. 111(d)(1) or 119(b)(1) or an amended Statement of Account filed with the Office pursuant to §§ 201.11(h) or 201.17(m).

(9) *Statutory licensee* or *licensee* means a cable system or satellite carrier that filed a Statement of Account with the Office under 17 U.S.C. 111(d)(1) or 119(b)(1).

(c) *Notice of intent to audit.* (1) Any copyright owner that intends to audit a Statement of Account for an accounting period beginning on or after January 1, 2010 must provide written notice to 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 must be received in the Office between December 1st and December 31st, and a copy of the notice must be provided to the statutory licensee on the same day that it is filed with the Office. Between January 1st and January 31st of the next calendar year the Office will publish a notice in the FEDERAL REGISTER announcing the receipt of the notice of intent to audit. A notice of intent to audit may be filed by an individual copyright owner or a designated agent that represents a group or multiple groups of copyright owners. The notice shall include a statement indicating that it is a “notice of intent to audit” and it shall contain the following information:

(i) It shall identify the licensee that filed the Statement(s) with the Office, and the Statement(s) and accounting period(s) that will be subject to the audit.

(ii) It shall identify the party that filed the notice, including its name, address, telephone number, and email address, and it shall include a statement that the party owns, or represents one or more copyright owners that 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) that will be subject to the audit.

(2) Notwithstanding the schedule set forth in paragraph (c)(1) of this section, any copyright owner that intends to audit a Statement of Account pursuant to an expanded audit under paragraph (n) of this section may provide written notice to the Register of Copyrights during any month, but no later than three years after the last day of the year in which the Statement was filed with the Office. A copy of the notice must be provided to the licensee on the same day that the notice is filed with the Office. Within thirty days after the notice has been received, the Office will publish a notice in the FEDERAL REGISTER announcing the receipt of the notice of intent to conduct an expanded audit. A notice given pursuant to this paragraph may be provided by an individual copyright owner or a designated agent that represents a group or multiple groups of copyright owners. The notice shall include a statement indicating that it is a “notice of intent to conduct an expanded audit” and it shall contain the information specified in paragraphs (c)(1)(i) and (ii) of this section.

(3) Within thirty days after a notice is published in the FEDERAL REGISTER pursuant to paragraphs (c)(1) or (2) of this section, any other copyright owner that 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 that wishes to participate in the audit of such Statement(s) must provide written notice of such participation to the licensee and to the party that filed the notice of intent to audit. A notice given pursuant to this paragraph may be provided by an individual copyright owner or a designated agent that represents a group or

multiple groups of copyright owners, and shall include the information specified in paragraphs (c)(1)(i) and (ii) of this section.

(4) Notices submitted under paragraphs (c)(1) through (3) of this section should be addressed to the “U.S. Copyright Office, Office of the General Counsel” and should be sent to the address for time-sensitive requests set forth in § 201.1(c)(1).

(5) Once the Office has received a notice of intent to audit a Statement of Account under paragraphs (c)(1) or (2) of this section, a notice of intent to audit that same Statement will not be accepted for publication in the FEDERAL REGISTER.

(6) Once the Office has received a notice of intent to audit two Statements of Account filed by a particular satellite carrier or a particular cable system, a notice of intent to audit that same carrier or that same system under paragraph (c)(1) of this section will not be accepted for publication in the FEDERAL REGISTER until the following calendar year.

(7) If the Office has received or receives a notice of intent to audit prior to the effective date of this section, the Office will publish a notice in the FEDERAL REGISTER within thirty days thereafter announcing the receipt of the notice of intent to audit. In such a case, the audit shall be conducted using the procedures set forth in paragraphs (d) through (l) of this section, with the following exceptions:

(i) The participating copyright owners shall provide the statutory licensee with a list of three independent and qualified auditors pursuant to paragraph (d)(1) by March 16, 2015.

(ii) The auditor shall deliver his or her final report to the participating copyright owners and the licensee pursuant to paragraph (i)(3) of this section by November 1, 2015.

(d) *Selection of the auditor.*(1) Within forty-five days after a notice is published in the FEDERAL REGISTER pursuant to paragraph (c)(1) of this section, the participating copyright owners shall provide the statutory licensee with a list of three independent and qualified auditors, along with information reasonably sufficient for the 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 17 U.S.C. 111(d)(6) or 119(b)(2);

(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) Within five business days after receiving the list of auditors from the participating copyright owners, the licensee shall select one of the proposed auditors and shall notify the participating copyright owners of its selection. That auditor shall be retained by the participating copyright owners and shall conduct the audit on behalf of all copyright owners who own a work that was embodied in a secondary transmission made by the 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 independent and qualified as defined in this section. An auditor shall be considered independent and qualified if:

(i) He or she is a certified public accountant and a member in good standing with the American Institute of Certified Public Accountants (“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; 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.

(e) *Commencement of the audit.* (1) Within ten days after the selection of the auditor, the auditor shall meet by telephone or in person with designated representatives of the participating copyright owners and the statutory licensee to review the scope of the audit, audit methodology, and schedule for conducting and completing the audit.

(2) Within thirty days after the selection of the auditor, the licensee shall provide the auditor and a representative of the participating copyright owners with a 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) through (v) and 201.17(h). The list shall be signed by a duly authorized agent of the licensee and the signature shall be accompanied by the following statement: I, the undersigned agent of the statutory licensee, hereby declare under penalty of law that all statements of fact contained herein are true, complete, and correct to the best of my knowledge, information, and belief, and are made in good faith.

(f) *Failure to proceed with a noticed audit.* If the participating copyright owners fail to provide the statutory licensee with a list of auditors or fail to retain the auditor selected by the licensee pursuant to paragraph (d)(2) of this section, the Statement(s) of Account identified in the notice of intent to audit shall not be subject to audit under this section.

(g) *Ex parte communications.* Following the initial consultation pursuant to paragraph (e)(1) of this section and until the distribution of the auditor's final report to the participating copyright owners pursuant to paragraph (i)(3) of this section, there shall be no *ex parte* communications regarding the audit between the auditor and the participating copyright owners or their representatives; provided, however, that the auditor may engage in such *ex parte* communications where either:

(1) Subject to paragraph (i)(4) of this section, the auditor has a reasonable basis to suspect fraud and that participation by the licensee in communications regarding the suspected fraud would, in the reasonable opinion of the auditor, prejudice the investigation of such suspected fraud; or

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

(h) *Auditor's authority and access.* (1) The auditor shall have exclusive authority to verify all of the information reported on the Statement(s) 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) through (v) and 201.17(h) or whether a satellite carrier properly determined that any subscriber or group of subscribers is eligible to receive any broadcast signals under 17 U.S.C. 119(a).

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

(3) The audit shall be conducted during regular business hours at a location designated by the licensee with consideration given to minimizing the costs and burdens associated with the audit. If the auditor and the licensee agree, the audit may be conducted in whole or in part by means of electronic communication.

(4) With the exception of its obligations under paragraphs (d) and (e) of this section, a licensee may suspend its participation in an audit for no more than sixty days before the semi-annual due dates for filing Statements of Account by providing advance written notice to the auditor and a representative of the participating copyright owners,

provided however, that if the participating copyright owners notify the licensee within ten days of receiving such notice of their good faith belief that the suspension could prevent the auditor from delivering his or her final report to the participating copyright owners before the statute of limitations may expire on any claims under the Copyright Act related to a Statement of Account covered by that audit, the licensee may not suspend its participation in 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 the suspension.

(i) *Audit report.* (1) After reviewing the books, records, and any other information received from the statutory licensee, the auditor shall prepare a draft written report setting forth his or her initial conclusions and shall deliver a copy of that draft report to the licensee. The auditor shall then consult with a representative of the licensee regarding the conclusions set forth in the draft report for no more than thirty days. If, upon consulting with the licensee, the auditor concludes that there are errors in the facts or conclusions set forth in the draft report, the auditor shall correct those errors.

(2) Within thirty days after the date that the auditor delivered the draft report to the licensee pursuant to paragraph (i)(1) of this section, the auditor shall prepare a final version of the written report setting forth his or her ultimate conclusions and shall deliver a copy of that final version to the licensee. Within fourteen days thereafter, the licensee may provide the auditor with a written rebuttal setting forth its good faith objections to the facts or conclusions set forth in the final version of the report.

(3) Subject to the confidentiality provisions set forth in paragraph (l) of this section, the auditor shall attach a copy of any written rebuttal timely received from the licensee to the final version of the report and shall deliver a copy of the complete final

report to the participating copyright owners and the licensee. The final report must be delivered by November 1st of the year in which the notice was published in the FEDERAL REGISTER pursuant to paragraph (c)(1) of this section and within five business days after the last day on which the licensee may provide the auditor with a written rebuttal pursuant to paragraph (i)(2) of this section. 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 underpayment or overpayment on any Statement(s) examined in the audit, as applicable. The notice should be addressed to the “U.S. Copyright Office, Office of the General Counsel” and should be sent to the address for time-sensitive requests specified in § 201.1(c)(1).

(4) Prior to the delivery of the final report pursuant to paragraph (i)(3) of this section the auditor shall not provide any draft of his or her report to the participating copyright owners or their representatives; provided, however, that the auditor may deliver a draft report simultaneously to the licensee and the participating copyright owners if the auditor has a reasonable basis to suspect fraud.

(j) *Corrections, supplemental payments, and refunds.* (1) If the auditor concludes in his or her final report 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 Office for that period was too low, a statutory licensee may cure such incorrect or incomplete information or underpayment by filing an amendment to the Statement and, in case of a deficiency in payment, by depositing supplemental royalty fee payments with the Office using the procedures set forth in §§ 201.11(h) or 201.17(m), provided that the amendment and/or

payments are received within sixty days after the delivery of the final report to the participating copyright owners and the licensee or within ninety days after the delivery of such report in the case of an audit of an MSO, and further provided that the licensee reimburses the participating copyright owners for the licensee's share of the audit costs, if any, determined to be owing pursuant to paragraph (k)(3) of this section. Supplemental royalty fee payments made pursuant to this paragraph shall be delivered to the Office and not to participating copyright owners or their representatives.

(2) Notwithstanding §§ 201.11(h)(3)(i) and 201.17(m)(4)(i), if the auditor concludes in his or her final report that there was an overpayment on a particular Statement, the licensee may request a refund from the Office using the procedures set forth in §§ 201.11(h)(3) or 201.17(m)(4), provided that the request is received within sixty days after the delivery of the final report to the participating copyright owners and the licensee or within ninety days after the delivery of the final report in the case of an audit of an MSO.

(k) *Costs of the audit.* (1) No later than the fifteenth day of each month during the course of the audit, the auditor shall provide the participating copyright owners with an itemized statement of the costs incurred by the auditor during the previous month, and shall provide a copy to the licensee that is the subject of the audit.

(2) If the auditor concludes in his or her final report that there was no net aggregate underpayment or a net aggregate underpayment of five percent or less, the participating copyright owners shall pay for the full costs of the auditor. If the auditor concludes in his or her final report that there was a net aggregate underpayment of more than five percent but less than ten percent, the costs of the auditor are to be split evenly

between the participating copyright owners and the licensee that is the subject of the audit. If the auditor concludes in his or her final report that there was a net aggregate underpayment of ten percent or more, the licensee will be responsible for the full costs of the auditor.

(3) If a licensee is responsible for any portion of the costs of the auditor, a representative of the participating copyright owners shall provide the licensee with an itemized accounting of the auditor's total costs, the appropriate share of which should be paid by the licensee to such representative no later than sixty days after the delivery of the final report to the participating copyright owners and licensee or within ninety days after the delivery of such report in the case of an audit of an MSO.

(4) Notwithstanding anything to the contrary in paragraph (k) of this section, no portion of the auditor's costs that exceed the amount of the net aggregate underpayment may be recovered from the licensee.

(1) *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 17 U.S.C. 111(d)(6) or 119(b)(2).

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

(i) The auditor; and

(ii) Subject to the execution of 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 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 (l)(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.

(m) *Frequency and scope of the audit.* (1) Except as provided in paragraph (n)(2) of this section with respect to expanded audits, a cable system, MSO, or satellite carrier shall be subject to no more than one audit per calendar year.

(2) Except as provided in paragraph (n)(1) of this section, the audit of a particular cable system or satellite carrier shall include no more than two of the Statements of Account from the previous eight accounting periods submitted by that cable system or satellite carrier.

(3) Except as provided in paragraph (n)(3)(ii), an audit of an MSO shall be limited to a sample of no more than ten percent of the MSO's Form 3 cable systems and no more than ten percent of the MSO's Form 2 systems.

(n) *Expanded audits.* (1) If the auditor concludes in his or her final report that there was a net aggregate underpayment of five percent or more on the Statements of Account examined in an initial audit involving a cable system or satellite carrier, a copyright owner may expand the audit to include all previous Statements filed by that cable system or satellite carrier that may be timely noticed for audit under paragraph (c)(2)

of this section. The expanded audit shall be conducted using the procedures set forth in paragraphs (d) through (l) of this section, with the following exceptions:

(i) The expanded audit may be conducted by the same auditor that performed the initial audit, provided that the participating copyright owners provide the 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 using the procedure set forth in paragraph (d) of this section.

(ii) The auditor shall deliver his or her final report to the participating copyright owners and the licensee within five business days following the last day on which the licensee may provide the auditor with a written rebuttal pursuant to paragraph (i)(2) of this section, but shall not be required to deliver the report by November 1st of the year in which the notice was published in the FEDERAL REGISTER pursuant to paragraph (c) of this section.

(2) An expanded audit of a cable system or a satellite carrier that is conducted pursuant to paragraph (n)(1) of this section may be conducted concurrently with another audit involving that same licensee.

(3) If the auditor concludes in his or her final report that there was a net aggregate underpayment of five percent or more on the Statements of Account examined in an initial audit involving an MSO:

(i) The cable systems included in the initial audit of that MSO shall be subject to an expanded audit in accordance with paragraph (n)(1) of this section; and



(ii) The MSO shall be subject to an initial audit involving a sample of no more than thirty percent of its Form 3 cable systems and no more than thirty percent of its Form 2 cable systems, provided that the notice of intent to conduct that audit is filed in the same calendar year as the delivery of such final report.

(o) *Retention of records.* For each Statement of Account or amended Statement that a statutory licensee files with the Office for accounting periods beginning on or after January 1, 2010, the licensee shall maintain all records necessary to confirm the correctness of the calculations and royalty payments reported in each Statement or amended Statement for at least three and one-half years after the last day of the year in which that Statement or amended Statement was filed with the Office and, in the event that such Statement or amended Statement is the subject of an audit conducted pursuant to this section, shall continue to maintain those records until three years after the auditor delivers the final report to the participating copyright owners and the licensee pursuant to paragraph (i)(3) of this section.

**§201.17 [Amended]**

3. Amend § 201.17 as follows:

- a. In paragraphs (m)(2) and (m)(4)(i) by removing “(m)(3)” and adding in its place “(m)(4)”.
- b. In paragraphs (m)(2)(ii), (m)(4)(iii)(C), and (m)(4)(iv)(A) by removing “(m)(1)(iii)” and adding in its place “(m)(2)(iii)”.
- c. In paragraph (m)(4) by removing “(m)(1)” and adding in its place “(m)(2)”.
- d. In paragraph (m)(4)(iii)(A) by removing “(m)(1)(i)” and adding in its place “(m)(2)(i)”.

- e. In paragraph (m)(4)(iii)(B) by removing “(m)(1)(ii)” and adding in its place “(m)(2)(ii)”.
- f. In paragraph (m)(4)(vi) by removing “(m)(3)(i)” and adding in its place “(m)(4)(i)”.

Dated: September 10, 2014.

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Jacqueline C. Charlesworth,  
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Associate Register of Copyrights.

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