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**LIBRARY OF CONGRESS****Copyright Office****37 CFR Part 260****[Docket No. 96–5 CARP DSTR]****Determination of Reasonable Rates  
and Terms for the Digital Performance  
of Sound Recordings****AGENCY:** Copyright Office, Library of Congress.**ACTION:** Notice of proposed rulemaking.**SUMMARY:** The Copyright Office is publishing for public comment proposed rules that will govern SoundExchange, an unincorporated division of the Recording Industry Association of America, Inc., when it functions as the designated agent for the purpose of receiving royalty payments and statements of accounts from nonexempt subscription digital transmission services which make digital transmissions of sound recordings under a statutory license.**DATES:** Comments are due no later than May 21, 2003.**ADDRESSES:** An original and five copies of any comment shall be delivered by hand to: Office of the General Counsel, Copyright Office, James Madison Building, Room LM–403, First and Independence Avenue, SE., Washington, DC; or mailed to: Copyright Arbitration Royalty Panel (CARP), PO Box 70977, Southwest Station, Washington, DC 20024–0977.**FOR FURTHER INFORMATION CONTACT:** David O. Carson, General Counsel, or Tanya M. Sandros, Senior Attorney, Copyright Arbitration Royalty Panel, PO Box 70977, Southwest Station, Washington, DC 20024. Telephone: (202) 707–8380. Telefax: (202) 252–3423.**SUPPLEMENTARY INFORMATION:****Background**

[Section 106\(6\)](#) of the Copyright Act, title 17 of the United States Code, gives copyright owners of sound recordings an exclusive right to perform their copyrighted work publicly by means of a digital audio transmission. This right is limited by [section 114\(d\)](#), which allows certain noninteractive digital audio services to transmit sound recordings under a compulsory license,

provided that the services pay a reasonable royalty fee and comply with the terms of the statutory license.

Among the categories of services that may use the section 114 license are preexisting subscription services<sup>1</sup> of which there are only three: Digital Cable Radio Associates, now known as Music Choice; DMX Music, Inc. ("DMX"); and Muzak, L.P. ("Muzak").

Rates and terms for this license are established in one of two ways. Interested parties may either negotiate rates and terms which, if approved through a notice and public comment proceeding, become the final rules for the relevant license period.

Alternatively, if industry representatives cannot reach a voluntary settlement, the Librarian of Congress convenes a three-person Copyright Arbitration Royalty Panel ("CARP") for the purpose of determining the applicable rates and terms.

In 1995, the Librarian of Congress initiated the first rate adjustment proceeding for the purpose of setting rates and terms of payment for use of sound recordings by the preexisting services pursuant to the section 114 license. The three preexisting subscription services and the Recording Industry Association of America ("RIAA") participated in this proceeding which concluded with the issuance of a final rule and order by the Librarian of Congress. See 63 FR 25394 (May 8, 1998).

In that proceeding, the parties proposed, and the CARP adopted, a term which gave the RIAA the responsibility for collecting and distributing the royalty fees to all copyright owners. *Id.* at 25397. The Librarian adopted this term, then crafted additional regulations that afforded copyright owners a means to verify the accuracy of the royalty payments made by the RIAA collective,<sup>2</sup> established the value of each performance, specified the nature of the costs that RIAA may deduct from the royalty fees prior to distribution, and set forth a procedure for handling royalty fees in the case

where the collective is unable to identify or locate a copyright owner who is entitled to receive royalties collected under the statutory license.

RIAA appealed both the rate set by the Librarian and the additional conditions imposed on the RIAA collective in its capacity as the collection agent for copyright owners. See, *Recording Industry Ass'n v. Librarian of Congress*, 176 F.3d 528 (D.C. Cir. 1999). The United States Court of Appeals for the District of Columbia Circuit upheld the rate set by the Librarian and found that the Librarian has the authority to impose terms on copyright owners or their agents. However, it remanded for further consideration certain terms imposed on RIAA under 37 CFR 260.2(d), 260.3(d), 260.6(b), and 260.7, because the CARP had not considered these issues, leaving the record devoid of any evidence upon which to fashion any terms concerning the collection and distribution of the royalty fees. *Id.* at 536.

On February 13, 2001, the Copyright Office initiated a new proceeding to consider the terms remanded by the court with the issuance of a scheduling order, directing the parties to this proceeding to file their direct cases with the Office on April 17, 2001. See, Order in Docket No. 96-5 CARP DSTR (February 13, 2001). However, instead of filing a direct case on April 17, RIAA filed a petition to establish terms governing the RIAA collective and to suspend the scheduled proceeding. No party to the original proceeding objected to the proposed terms. In fact, Music Choice had already informed the Office by letter dated February 26, 2001, of its intent not to participate further in this proceeding and that it did not object to the terms to be proposed by RIAA.

Subsequently, RIAA revised these terms to remove a reference to the section 112 statutory license for the making of ephemeral copies and to make clear that membership in the collective is open only to those copyright owners whose works are subject to statutory licensing and thus generate the funds to be distributed by the collective. RIAA also asked the Copyright Office to publish the revised terms pursuant to § 251.63(b). This provision allows the Librarian of Congress to adopt proposed terms that are the result of settlement negotiations, provided that no person with a substantial interest and an intent to participate in a CARP proceeding files an objection. This procedure to adopt negotiated rates and terms in the case where an agreement has been reached has been specifically endorsed by Congress.

If an agreement as to rates and terms is reached and there is no controversy as to these matters, it would make no sense to subject the interested parties to the needless expense of an arbitration proceeding conducted under (section 114(f)(2) (1995)). Thus, it is the Committee's intention that in such a case, as under the Copyright Office's current regulations concerning rate adjustment proceedings, the Librarian of Congress should notify the public of the proposed agreement in a notice-and-comment proceeding and, if no opposing comment is received from a party with a substantial interest and an intent to participate in an arbitration proceeding, the Librarian of Congress should adopt the rates embodied in the agreement without convening an arbitration panel.

S. Rep. No. 104-128, at 29 (1995)(citations omitted).

Accordingly, the Copyright Office published the proposed terms in the **Federal Register** and requested public comment. 66 FR 38226 (July 23, 2001). In response to this notice, the American Federation of Musicians ("AFM") and the American Federation of Television and Radio Artists ("AFTRA") filed a Notice of Intent to Participate and objections to certain of the proposed terms. Shortly thereafter, RIAA began discussions with AFTRA and AFM, regarding their objections, and the matter has been held in abeyance.

Since that time, a significant event has occurred that bears directly on the resolution of this proceeding. In December of 2002, Congress passed the Small Webcaster Settlement Act of 2002 ("SWSA"), **Public Law 107-321**, 116 Stat. 2780. Among other things, the SWSA amended 17 U.S.C. 114(g) in two important ways which address specific issues which are the subject of this proceeding. First, the SWSA provides for direct payment to featured recording artists and to the administrators of the escrow accounts provided for in 17 U.S.C. 114(g)(2)(B)&(C). Second, the act allows a designated agent, prior to the distribution of the royalty receipts, to deduct reasonable costs incurred by that agent in the administration of those receipts, including, but not limited to, costs associated with the collection and distribution of the royalty fees and the costs incurred in the participation of negotiations or arbitration proceedings under sections 112 and 114.

Because of these changes in the law, RIAA has again revised its proposed amendments to 37 CFR 260 to conform the terms in dispute to the new law and, in doing so, it has addressed the concerns of AFM and AFTRA. Consequently, AFM and AFTRA have withdrawn their objections to the proposed terms and their Notice of Intent to Participate in a CARP

<sup>1</sup> A "preexisting subscription service" is defined as: A service that performs sound recordings by means of noninteractive audio-only subscription digital audio transmissions, which was in existence and was making such transmissions to the public for a fee on or before July 31, 1998, and may include a number of limited number of sample channels representative of the subscription service that are made available on a nonsubscription basis in order to promote the subscription service. 17 U.S.C. 114(j)(11).

<sup>2</sup> In November 2000, RIAA formed "SoundExchange," an unincorporated division of RIAA, to administer statutory licenses, including its responsibilities under the Librarian's May 8 Order. See, Revised RIAA Petition to Establish Terms Governing SoundExchange at 1 n.1.

proceeding. At this juncture, § 251.63(b) requires the publication of the proposed rules to provide those persons with a substantial interest in the proceeding with an opportunity to comment on the rules. Provided that no party who is entitled to participate in a CARP on remand of this proceeding and who has a substantial interest in the rules files an objection and a Notice of Intent to Participate in a CARP proceeding to resolve an objection within the scope of this proceeding, the proposed rules will be adopted as final regulations.

The proposed terms shall govern SoundExchange, the collecting rights entity that was formed from the designated RIAA collective, in its capacity as the sole agent designated to receive royalty payments from the three subscription services that were parties to this proceeding. Terms governing the administrative functions of any future collective or the designation of alternative agents shall be decided in future rate adjustment proceedings either through negotiations or after a hearing before a CARP based upon a fully developed written record. *See, e.g., 67 FR 45239* (July 8, 2002). For this reason, parties must limit their comments to the terms offered in the context of the proceeding to set rates and terms for the three subscription services—Music Choice, DMX, and Muzak—for the period October 28, 1998 (the effective date of the Digital Millennium Copyright Act) through December 31, 2001, the remand order, and the law as amended by the SWSA.

Should a person object to the proposed terms, he or she must file a written objection with the Copyright Office and an accompanying Notice of Intent to Participate. Any proceeding convened to consider these terms would be a continuation of the prior CARP proceeding, Docket No. 96–5 CARP DSTR, on remand from the United States Court of Appeals for the District of Columbia Circuit. *See, 17 U.S.C. 802(g)*. Therefore, the content of the written challenge must include a statement explaining the basis of the person's substantial interest in that proceeding and entitlement to participate in that proceeding, the proposed rule the person finds objectionable, and the reasons for the challenge. If no comments are received, the regulations shall become final upon publication of a final rule.

#### List of Subjects in 37 CFR Part 260

Copyright, Digital Audio Transmissions, Performance Right, Sound Recordings.

#### Proposed Regulation

In consideration of the foregoing, the Copyright Office proposes amending part 260 of 37 CFR as follows:

#### PART 260—USE OF SOUND RECORDINGS IN A DIGITAL PERFORMANCE

1. The authority citation for part 260 continues to read as follows:

**Authority:** 17 U.S.C. 114, 801(b)(1).

#### § 260.2 [Amended]

2. In § 260.2, remove paragraph (d).

3. Section 260.3 is amended by revising paragraphs (c), (d), and (e) to read as follows:

#### § 260.3 Terms for making payments of royalty fees.

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(c) The agent designated to receive the royalty payments and the statements of account shall have the responsibility of making further distribution of these payments to those parties entitled to receive such payments according to the provisions set forth at 17 U.S.C. 114(g)(2); Provided that the designated agent shall only be responsible for making distributions to those parties who provide the designated agent with such information as is necessary to identify and pay the correct recipient for such payments. The agent shall distribute royalty payments on a reasonable basis that values all performances by a Licensee equally based upon the information provided by the Licensee pursuant to the regulations governing records of use of performances by Licensees; Provided, however, that parties who have designated the agent may agree to allocate their shares of the royalty payments made by any Licensee among themselves on an alternative basis. Parties entitled to receive payments under 17 U.S.C. 114(g)(2) may agree with the designated agent upon payment protocols to be used by the designated agent that provide for alternative arrangements for the payment of royalties consistent with the percentages in 17 U.S.C. 114(g)(2).

(d) The designated agent may deduct from the payments made by Licensees under § 260.2, prior to the distribution of such payments to any person or entity entitled thereto, all incurred costs permitted to be deducted under 17 U.S.C. 114(g)(3); Provided, however, that any party entitled to receive royalty payments according to 17 U.S.C. 114(g)(2) may agree to permit the designated agent to deduct any additional costs.

(e) Commencing June 1, 1998, and until such time as a new designation is made, SoundExchange, which currently is an unincorporated division of the Recording Industry Association of America, Inc., shall be the agent that receives royalty payments and statements of account under this part 260 and shall continue to be designated as such if it should be separately incorporated.

4. Section 260.6 is revised to read as follows:

#### § 260.6 Verification of royalty payments.

(a) *General.* This section prescribes general rules pertaining to the method of verification of the payment of royalty fees by the designated agent to interested parties; Provided, however, that the designated agent and any interested person may agree as to an alternative method of verification.

(b) *Frequency of verification.* Interested parties may conduct a single audit of the designated agent during any given calendar year and no calendar year shall be subject to audit more than once.

(c) *Notice of intent to audit.* Interested parties must file with the Copyright Office a notice of intent to audit the designated agent. Such notice of intent shall also be served at the same time on the designated agent to be audited. Within 30 days of the filing of the notice of intent, the Copyright Office shall publish in the **Federal Register** a notice announcing such filing.

(d) *Retention of records.* The interested party requesting the verification procedure shall retain the report of the verification for a period of three years.

(e) *Acceptable verification procedure.* An audit, including underlying paperwork, which was performed in the ordinary course of business according to generally accepted auditing standards by an independent auditor, shall serve as an acceptable verification procedure for all interested parties.

(f) *Costs of the verification procedure.* The interested parties requesting the verification procedure shall pay for the cost of the verification procedure, unless an independent auditor concludes that there was an underpayment of five (5) percent or more, in which case, the designated agent shall bear the costs of the verification procedure.

(g) *Interested parties.* For purposes of this section, interested parties are those individuals or entities who are entitled to receive royalty payments pursuant to 17 U.S.C. 114(g)(2), or their designated agents.

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5. Section 260.7 is amended by removing the word “collecting” after the phrase “If the designated”; by removing the word “collecting” each place it appears and adding the word “designated” in its place; and in the last sentence, by removing the word “fees” and adding the word “payments” in its place.

Dated: April 15, 2003.

**David O. Carson,**

*General Counsel.*

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