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PUBLIC VERSION

Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
The Library of Congress

In re

Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III)

Docket No. 16–CRB–0001–SR/PSSR (2018–2022) (Remand)

MUSIC CHOICE'S OPENING REMAND BRIEF

PUBLIC VERSION

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INTRODUCTION

In this proceeding, the Judges referred two questions to the Register of Copyrights regarding the legal standard for whether Music Choice's transmission of its music channels to subscribers via internet fell within the scope of the PSS license. In response, the Register set out a framework for analyzing whether any particular transmissions fall within the scope of the PSS license, consisting of three possible categories: (1) existing service offerings, comprising transmissions made in the same medium of transmission used in 1998; (2) expanded service offerings, comprising transmissions of a similar service in a medium other than one used in 1998; and (3) different service offerings, comprising transmissions that did not fall within the first two categories because they constitute fundamentally different services than the existing service offerings. The Register then ruled that Music Choice's internet transmissions could not be part of an "existing service offering" as a matter of law, even if Music Choice did in fact transmit its service via internet on July 31, 1998, and outlined a new, multi-factor test to determine whether a service offering that was ***not*** an existing service offering qualifies as an expanded service offering – and therefore fell within the scope of the PSS license – or was instead a different service offering – and therefore fell outside the scope of the PSS license.

The Judges – as required by the Copyright Act – applied the Register's ruling in the Final Determination and found that Music Choice's internet transmissions could not be part of an existing service offering and while those transmissions received inside the home qualified as expanded service offerings, to the extent Music Choice subscribers receive the service while outside their homes such transmissions are a different service offering and fall outside the scope of the PSS license. The Judges also granted SoundExchange's request to modify the royalty audit provision applicable to the PSS, which from the very first PSS regulations have always allowed a

PSS to conduct its own proactive "defensive" audits of it royalty payments. As this provision has stood for over twenty years, as long as the defensive audits were conducted under the same stringent standards required of SoundExchange's audits – by an independent, qualified auditor under generally accepted auditing standards – the PSS could minimize the burden, expense, and potential harassment of a SoundExchange audit while still protecting royalty recipients' legitimate interests in ensuring accurate royalty payments. Although SoundExchange did not provide any evidence justifying its change to the regulation after twenty years, the Judges implemented that change.

These two specific rulings were the only parts of the Final Determination that were appealed. On that appeal, the D.C. Circuit held that both rulings were erroneous. On the first point, the court ruled that the Register erred by interpreting the relevant provisions of the Copyright Act to exclude Music Choice's internet transmissions from treatment as an existing service offering as a matter of law, even if Music Choice was in fact transmitting its service via internet in 1998. With respect to the second point, the D.C. Circuit held that the Judges erred by modifying the defensive audit provision – which had been relied upon in its existing state by Music Choice for years – without any evidentiary basis. The court vacated the Register's legal opinion in its entirety, and vacated only the sections of the Final Determination finding that Music Choice's internet transmissions were – in part – outside the scope of the PSS license and modifying the language in the royalty audit provision.

Now that the D.C. Circuit has ruled on the statutory language distinguishing existing service offerings from expanded service offerings, it is clear that Music Choice's internet transmissions fall within the scope of the PSS license – irrespective of where they are received. As the D.C. Circuit noted, it was undisputed in the record of this proceeding that Music Choice

had, in fact, been transmitting its music channels via the internet since well before July 31, 1998. On remand, Music Choice is providing even more evidence of this fact, including more detailed testimony and documentary evidence. Thus those transmissions today must be evaluated as part of an existing service offering.

As the Register held in the portion of her Opinion that was not infected by the error reversed on appeal, a PSS has broad leeway to significantly develop, expand, and improve its service in the same media of transmission used in 1998. Although Music Choice has greatly improved its music channels since 1998, including to adapt to improvements and changes in cable, satellite, and internet technologies, it is still fundamentally the same bundle of non-interactive, digital audio channels transmitted to consumer subscribers. As the Register held, an existing service offering – unlike an expanded service offering – is allowed to take advantage of new features and capabilities enabled by subsequent advancements in the same transmission media used in 1998. Improvements in wireless mobile internet access certainly fall within that allowance. However, the Music Choice service has been available outside the home, including on desktop and portable computers, since 1996 and Music Choice was already investing in technology to enable access on mobile internet devices prior to 1998. Moreover, current cable and satellite television industry standards and practices recognize mobile internet access to television channels as part and parcel of the cable and satellite television service offered by MVPDs. And the Music Choice channels and interface offered via internet today are fundamentally the same as those offered on the television. There are simply no grounds upon which to find those transmissions are a completely different service offering.

With respect to the defensive audit provision, the D.C. Circuit made clear that SoundExchange must present real evidence of a substantial need to make the change it seeks. It

has not and cannot do so. The evidence shows that the provision is still needed. When allowed to conduct its own "audits," SoundExchange actually does nothing of the sort. Rather than hire independent, qualified auditors to conduct audits under generally accepted auditing standards ("GAAS") SoundExchange instead hires partisan forensic accountants who expressly disclaim following GAAS and instead operate under a different consulting standard that actually requires the opposite of independence. Not surprisingly, the resulting "examinations" are vexatious and wildly burdensome. Under the consulting standard, SoundExchange's accountants operate as mere mouthpieces for SoundExchange, adopting SoundExchange's hyper-aggressive interpretations of the regulations – no matter how facially absurd – and creating phony underpayment findings based on those misinterpretations to maximize and inflate SoundExchange's claims.

After enduring one such experience in 2005 – in which SoundExchange hired a member of its own Board of Directors (without identifying this conflict to Music Choice) as its "independent auditor" who initially fabricated massive "claims" that ultimately settled for a small fraction of the disputed amount – Music Choice has ever since relied on defensive audits. The result has been a near-perfect record of timely PSS payments and in the handful of instances where slightly late payments were found where the interest had not been fully paid, Music Choice was able to promptly remit those small interest payments far sooner than they would have been paid under a SoundExchange audit. Nor does the fact that Music Choice's independent auditors use a "sampling" methodology somehow render the scope of the audits incomplete. Sampling is widely used and consistent with GAAS. Even SoundExchange's own forensic accountants use sampling in their non-audit "examinations." There simply is no justification to change the existing regulatory language that the parties have been working under

for over twenty years.

ARGUMENT

I. Legal Framework Regarding Internet Transmissions by a PSS

After the close of the record in this proceeding, the Judges asked the Register of Copyrights to rule on two novel questions of law relating to whether a PSS's use of the internet to transmit music channels to subscribers via websites or mobile software applications fell within the scope of the PSS license. *See Scope of Preexisting Subscription Services*, 82 Fed. Reg. 59,652, 59,654 (December 6, 2017) (the "Register's Ruling").

In answering that referral, the Register noted that the Copyright Act distinguishes between PSS transmissions made in the same media of transmission used by a PSS on July 31, 1998 and those made in a new medium of transmission. *Id*. at 59,657. The Register also ruled that a PSS has substantial leeway to grow, adapt, and change its PSS in the same transmission media, but when it expands into new transmission media a PSS is more restricted. The Register then ruled that, as a matter of law, it was irrelevant whether or not Music Choice was actually transmitting its PSS using the internet in 1998 and that any internet transmissions today must be evaluated using the more restrictive test for expansion into a new medium of transmission. Register's Ruling, *Id*. at 59,658.

The Board incorporated the Register's Ruling into its Final Determination, and applied the Register's multi-factor test for expanded service offerings to find that, "an internet-based service that allows subscribers to access music outside their residences is a 'different service offering' and is not eligible for grandfathered PSS rate structures or license requirements applicable to PSS." *Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and "Preexisting" Subscription Services (SDARS III)* Docket No.

16-CRB-0001 SR/PSSR (2018- 2022), 83 Fed. Reg. 65,210, at 65,227 (Dec. 19, 2018) (the "Final Determination").

On appeal, the D.C. Circuit held that the Register had erred in her statutory interpretation by excluding internet transmissions from the existing service offering category as a matter of law: "Without regard to the text of the statute, which makes no distinction between transmission media, the Register determined that only those transmission media identified in the DMCA Conference Report would be entitled to the grandfathered rate." *Music Choice v. Copyright Royalty Bd.*, 970 F.3d 418, 426–27 (D.C. Cir. 2020). As the D.C. Circuit noted, "[t]he text does not single out internet transmissions for categorical exclusion from the grandfathered rate." *Id.* at 427. While this erroneous interpretation was the foundation for much of the Register's Ruling and led the D.C. Circuit to vacate her Ruling in its entirety, the Register's basic analytical framework regarding the three categories of service offerings and the rest of her analysis of the scope of existing service offerings were neither appealed by any party nor altered by the D.C. Circuit's opinion. Thus, these limited elements of the Register's Ruling provide helpful guidance with respect to the applicable legal framework on remand.

Specifically, in her Ruling, the Register identified three categories of service offerings that a PSS entity might make. First, an "existing service offering," is a non-interactive audio subscription service offered as of July 31, 1998 that is still offered today in the same transmission medium used on that date.[1] The Register noted that "[s]uch a service offering would be entitled to both a rate established under the grandfathered rate standard under section 114(f)(1) and the grandfathered license requirements in section 114(d)(2)(B)." Register's Ruling

[1] In her Ruling, the Register additionally limited the transmission media to those "identified by Congress" in the legislative history of the DMCA. This limitation was based upon her erroneous statutory interpretation that was reversed on appeal and is no longer applicable on remand.

at 59,657.

Second, an "expanded service offering," is a non-interactive audio subscription service offered as of July 31, 1998 that is still offered today, but in a different transmission medium than one used by the PSS in 1998, where only transmissions similar to the existing service offering are provided. The Register noted that "[s]uch a service offering would be entitled to a rate established under the grandfathered rate standard under section 114(f)(1), but would not be able to take advantage of the grandfathered license requirements in section 114(d)(2)(B). Instead, it would be required to comply with more detailed license requirements in section 114(d)(2)(C)." *Id*.

Third, a "different service offering," is a "service offering that is not an existing service offering or an expanded service offering. . . A different service offering would not be entitled to either a rate established under the grandfathered rate standard under section 114(f)(1) or the grandfathered license requirements in section 114(d)(2)(B)." *Id*.

There are other key distinctions between existing and expanded service offerings. Expanded service offerings have certain limitations on their ability to introduce new features and functionality, particularly where those new features take advantage of unique capabilities inherent in the new transmission medium and are significantly different from features available on the existing service offering. *See id*. at 59,659, n.78. In contrast, the Register held that existing service offerings have broad latitude to evolve within the different media used by that service in 1998 to improve the service and keep apace of technological change, consumer preferences, and other market developments. *Id*. at 59,658. As the Register explained in an earlier legal referral on the scope of the PSS license:

> While it would appear . . . that Congress's purpose in grandfathering these services was to preserve a particular program offering, it was not its only purpose

> or even necessarily its major goal. . . . It understood that the entities so designated as preexisting had invested a great deal of resources into developing their services under the terms established in 1995 as part of the Digital Performance Right in Sound Recordings Act of 1995, and that those services deserved to ***develop*** their businesses accordingly.

Designation as a Preexisting Subscription Service, 71 Fed. Reg. 64,639, 64,645 (Nov. 3, 2006) (emphasis added). A music service cannot continue to develop its business with respect to that service without constantly improving and adapting to market changes.

Indeed, the Register in this proceeding emphasized that a PSS must be permitted to evolve and develop the features of its service within the general transmission media it used in 1998, noting that:

> an existing service offering can grow and expand significantly within the same transmission medium while remaining a PSS offering. The Register has found no indication that Congress meant to freeze existing service offerings exactly as they were on July 31, 1998, in order for them to continue to qualify for the grandfathering provisions. The user interface can be updated, certain functionality can be changed, the number of subscribers can grow, and channels can be added, subtracted, or otherwise changed. The only restriction is that the existing service offering as it is today must be fundamentally the same type of offering that it was on July 31, 1998—i.e., it must be a noninteractive, residential, cable or satellite digital audio transmission subscription service.

Register's Ruling at 59,658.

The D.C. Circuit subsequently ruled that the Register should not have categorically excluded internet from the transmission media eligible for the unconditional grandfathered royalty rate. *Music Choice*, 970 F.3d at 426. And as demonstrated below, the term "residential" as applied to Music Choice's service and all other television programming services merely refers to the type of subscriber – consumer as opposed to business subscribers. Consequently, the only requirement for the evolution of Music Choice's PSS to remain within the scope of the license is that the service must remain a non-interactive digital audio transmission service that is transmitted to consumer subscribers through cable, satellite, or internet. As demonstrated below,

that is exactly what Music Choice's PSS is – whether transmitted to subscribers' televisions, computers, phones, or other internet-connected devices.

II. Music Choice's PSS Internet Transmissions Are Part of Its Existing Service Offering.

Now that the D.C. Circuit has clarified the relevant statutory text, it is beyond serious dispute that Music Choice's music channels delivered to subscribers via internet are part of its existing service offering – including when received outside the home – and are therefore included within the scope of the PSS license. Music Choice began transmitting its music channels to subscribers via internet well before July 31, 1998 and has continued to do so to this day. Those internet transmissions have always been available to subscribers outside the home. Although various improvements have been made to Music Choice's consumer service over the past twenty-five years as cable, satellite, and internet technology has evolved, the service received via the internet is the same service received on the television and is still fundamentally the same Music Choice service provided in 1998: a package comprising multiple channels of non-interactive, radio-type music audio channels programmed in narrow genres and sub-genres and made available to consumer subscribers.

A. Music Choice Was Transmitting Its PSS Via the Internet on July 31, 1998

As the D.C. Circuit noted, "[i]t is undisputed that Music Choice had been providing some digital audio transmissions over the internet since 1996 and was still doing so on July 31, 1998." *Music Choice*, 970 F.3d at 425. At the hearing, David Del Beccaro, Co-President, CEO and founder of Music Choice, testified that Music Choice was making internet transmissions in 1998. May 18, 2017 Hearing Tr. at 4599:2-18 (Del Beccaro). SoundExchange introduced no evidence contradicting that testimony in any way.

On remand, Mr. Del Beccaro submits further sworn testimony establishing beyond doubt

that Music Choice launched its internet transmissions prior to 1998. Mr. Del Beccaro explains that shortly after the Music Choice service was launched, it expanded from traditional cable systems into other types of MVPDs, such as telephone company systems and satellite television providers, and that starting in the early 1990s, Music Choice began working on ways to transmit its music channels over the internet. Del Beccaro Decl. ¶¶ 7-9. It first achieved this on a test basis in 1993 or 1994. *Id*. ¶ 7.

After investing significant time and resources, Music Choice was ultimately able to develop technology that enabled it to be the first music service to multicast over the internet, and launched that feature as part of its consumer subscription service in 1996. *Id*. ¶ 8. Music Choice sometimes referred to the feature as a "cable modem" offering in those early days because MVPDs were beginning to offer high speed internet access via devices called "cable modems." With Music Choice's internet-based feature, consumers who received internet service from their MVPD could access the Music Choice music channels on any device connected to the internet (typically a computer at that time). The subscriber could log into a portal using either a web browser or in some cases a separate software application to authenticate themselves as a subscriber. After authentication, the subscriber could select from various Music Choice channels and listen while surfing the web or doing anything else on their connected device. *Id*. ¶¶ 8-9.

Music Choice's internet feature was first launched with a few individual systems within a few of Music Choice's MVPD affiliates. The first system to launch the feature was Continental Cablevision's Jacksonville system. Continental began providing the Music Choice service via internet in September of 1996. *Id*. ¶ 10. Over the remainder of 1996 and 1997, various other MVPDs, including Time Warner Cable, Adelphia, Comcast, MediaOne, and Cox began providing Music Choice's music channels via internet. *Id*. By July of 1998, the internet access

feature was available in multiple regions through the MVPDs named above, and others. *Id*. ¶ 11.

Internal Music Choice records from the time period when Music Choice launched its internet service further substantiate Mr. Del Beccaro's testimony. *Id*. at ¶¶ 12-18. For example, in 1995 Music Choice sought public performance licenses from major performing rights organizations to cover internet transmission of the Music Choice service. *Id.* at ¶ 7, Ex. MC 10. Various records from partnership board meetings prior to 1998 contain references to the launch, roll-out, and success of Music Choice's internet feature. *Id.* at ¶ 15, Ex. MC 12 (Music Choice October 11, 1996 partners' meeting presentation discussing Music Choice's cable modem activities including the September 1996 launch of the internet feature on Continental's Jacksonville system, as well as imminent launches in Time Warner's Akron system, Adelphia's Coudersport and Tom's River systems, Comcast's Bryn Mawr system, and Cox's Orange County, California system, and the potential for rolling out internet access via Bell South's telephone-based MVPD); *id*. at ¶ 16; Ex. MC 13 (Music Choice's February 13, 1997 partners' meeting presentation updating on internet offering and noting expectation that "modem opportunities to expand to every partner by 6/97. . . Jacksonville continues to be successful. . . MUSIC CHOICE most used site."). Certain affiliate agreements prior to 1998 included terms [[ ]]. *Id.* at ¶ 18, Ex. MC 15.

Documents from the years after it launched its internet offering further corroborate Music Choice's internet feature as of 1998. Music Choice frequently includes a timeline of "Music Choice firsts" in its internal and marketing presentations. That timeline has always – and for many years prior to the topic becoming an issue in this proceeding – included a reference to Music Choice having the first music multicast over the internet in 1996. It is a point of pride for the company that it has been first to do so many things that later became industry standard

practices. *Id.* at ¶ 13, Ex. MC 11. *See also* Trial Ex. 418, Music Choice Partner Update, 2/21/2013, p. 15 ("MC has been doing TV Everywhere since 1996.").

Third-party sources from shortly after the relevant time period also recognize that Music Choice was operating an internet service at the time of the DMCA. For example, a 2000 article in the Journal of the Copyright Society of the USA, discussing the history of digital audio cable services in the context of the 1995 digital performance rights legislation, explained that "DAC [Digital Audio Cable] services, including those already in place at the time, were another type of digital transmission that Congress was concerned with during its consideration of the DPRSRA", identified Music Choice as one of the two major DACs that emerged in that time period and noted that "Music Choice provides service via cable, satellite, or the Internet." Eric D. Leach, *Everything You Always Wanted to Know about Digital Performance Rights but Were Afraid to Ask*, 48 J. COPYRIGHT Soc'y U.S.A. 191 at 223, and n. 195 & 198. (2000).

B. Music Choice's PSS Was Available Outside the Home on July 31, 1998.

As a preliminary matter, the distinction between existing and expanded service offerings is solely based upon the media of transmission. The location where the transmission is received should be irrelevant. Nonetheless, Music Choice's internet transmissions of its PSS music channels have always been available outside the home, including on July 31, 1998.

From the time when Music Choice first launched its internet feature back in 1996, those transmissions have always been available to subscribers outside of their homes. Del Beccaro Decl. ¶ 43. The very first version of the service was marketed to the MVPDs' high speed internet customers and in 1996 was typically received on a computer because computers were the most common devices connected to the internet at that time. To access the service on a computer, the subscriber needed to use a web browser – which is merely a type of software application – or

for some affiliates the subscriber would use a separate software application to allow the user to enter login credentials to verify that they were a subscriber. *Id.* At that time, some affiliates had sections of their own websites for this purpose, and others had their subscribers log in through Music Choice's internet server. *Id*. Once authenticated, the subscriber could use the interface on the browser or other app to select one of several Music Choice music channels and listen to music while they surfed the web or did anything else so long as the computer remained connected to the internet. *Id*.

There was nothing about this implementation that necessarily limited access to within the subscriber's home. *Id*. ¶ 44. Although at the very beginning, certain affiliates linked the service to subscribers using cable modems, those cable modems were provided to commercial as well as consumer locations, so the service could be available to consumer subscribers at their workplace. Moreover, after going through the trouble of providing web-based access for those subscribers the affiliates quickly eliminated any restriction and allowed access to high speed internet and television subscribers using any internet-connected device. *Id*. ¶ 45. Other affiliates never limited the service solely to cable modems. *See id*. In any event, by July 31, 1998, the music channels were being transmitted via internet to any internet-connected device used by subscribers at several different Music Choice MVPD affiliates. *Id.*

Internet access has always been available outside the home, even when consumers typically used personal computers for such access. Census data from 1998 showed that at that time, almost as many Americans accessed the internet from outside the home as those who did so from inside the home. *See Falling Through the Net Defining the Digital Divide*, Part II.B.1, https://www.ntia.doc.gov/legacy/ntiahome/fttn99/contents.html (17.0% used the internet from locations outside the home, while 22.2% used the internet from home). In addition to being able

to log on from computers in the workspace, schools, libraries, etc., portable laptop computers were able to access the internet by 1998. Del Beccaro Decl. ¶¶ 46-47. Although other types of mobile internet-connected devices were not yet widely available at that time, there were many in development and Music Choice had begun working on ways to make its service available on such devices prior to July 31, 1998. *Id.* ¶ 47. By 2000, Music Choice had begun transmitting its Music Channels to subscribers using the earliest mobile internet devices. *Id.* ¶ 48. By 2004, Music Choice was transmitting the service to Sprint mobile phone subscribers. *Id.* But the work to develop software and other technology necessary to transmit to these mobile devices had begun before July 31, 1998.

C. Music Choice's Internet Transmissions Today Are Still Fundamentally Part of the Same Service Offered in 1998.

Music Choice's PSS offering (whether received on the TV or on internet-connected devices) has certainly evolved over the years. But this is precisely what Congress intended to allow. The legislative purpose and history of the PSS license makes clear that, especially within transmission media used prior to the enactment of the DMCA, a PSS may evolve, grow, and adapt to new technologies used in those transmission media as well as consumer preferences and market changes.

With the passage of the DMCA, in recognition of the PSS' legitimate business expectancies as pioneers who launched the very first digital music services under a different legal and licensing landscape than those that would enter the market in the future, Congress continued to apply the Section 801(b)(1) policy-based rate standard to the PSS, even while it moved future market entrants to a marketplace standard. *Music Choice v. Copyright Royalty Bd.*, 774 F.3d 1000, 1004 (D.C. Cir. 2014) (noting that legislative purpose of PSS license is "to protect the investment of noninteractive services that had come into existence before the

recognition of the digital performance right."); Conference Report of the Committee of Conference on the Disagreeing Votes of the Two Houses on the Digital Millennium Copyright Act, H.R. Rep. No. 105-796 at 80–81 (1998); Designation as a Preexisting Service, 71 Fed. Reg. 64,639, 64,645–46.

The legislative history's reference to the "existing operations" of the PSS does not mean that Congress intended to limit PSS status to the PSS offerings as they existed in 1998 or otherwise to freeze the PSS in time. One of the very purposes for applying the Section 801(b)(1) policy-based rate standard to the PSS was to protect the PSS' "need for access to the works at a price that would ***not hamper their growth***." *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings (Final Rule and Order)*, 63 Fed. Reg. 25,394, 25,409 (May 8, 1998) (emphasis added). As the Register explained in an earlier legal referral on the scope of the PSS license:

> While it would appear . . . that Congress's purpose in grandfathering these services was to preserve a particular program offering, it was not its only purpose or even necessarily its major goal. . . . It understood that the entities so designated as preexisting had invested a great deal of resources into developing their services under the terms established in 1995 as part of the Digital Performance Right in Sound Recordings Act of 1995, and that those services deserved to ***develop*** their businesses accordingly.

Designation as a Preexisting Service, 71 Fed. Reg. at 64,645 (emphasis added). As noted above, a music service cannot continue to grow or develop its business with respect to that service without constantly improving and adapting to market changes.

Indeed, in this proceeding the Register emphasized that a PSS must be permitted to evolve and develop the features of its service within the general transmission media it used in 1998, noting that:

> an existing service offering can grow and expand significantly within the same transmission medium while remaining a PSS offering. The Register has found no

> indication that Congress meant to freeze existing service offerings exactly as they were on July 31, 1998, in order for them to continue to qualify for the grandfathering provisions. The user interface can be updated, certain functionality can be changed, the number of subscribers can grow, and channels can be added, subtracted, or otherwise changed. The only restriction is that the existing service offering as it is today must be fundamentally the same type of offering that it was on July 31, 1998—i.e., it must be a noninteractive, residential, cable or satellite digital audio transmission subscription service.

Register's Ruling, 82 Fed. Reg. at 59,658. As explained, supra, p. 8, the Register's omission of internet transmissions from this legal standard was reversed on appeal and the term "residential" must be given its actual industry meaning in the context of MVPD subscribers. But the Register's ruling is otherwise correct: the only restriction on the evolution of a PSS's existing service offering is that it must remain fundamentally the same type of offering – it must be a non-interactive, cable, satellite, or internet digital audio transmission service offered to consumer subscribers. Music Choice's transmission of its music channels to subscribers via internet clearly satisfy that requirement. They are non-interactive, internet digital audio transmissions offered to Music Choice's consumer service subscribers. Moreover, although this is not required, they are exact same types of channels transmitted to those subscribers on their television sets – and in most instances they are the exact same channels.

Given that Music Choice was transmitting its service via internet in 1998, it was allowed to develop the internet features to take advantage of improvements in internet-related technology, just as it has been allowed to develop its cable and satellite features to take advantage of changes in those technologies. Consequently, it is not necessary for Music Choice's internet-based channels to be the same as its television-based channels in order to remain an existing service offering. As the Register noted with respect to an existing service offering within a particular transmission medium: "[t]he user interface can be updated, certain functionality can be changed, the number of subscribers can grow, and channels can be added, subtracted, or

otherwise changed." Register's Ruling, 82 Fed. Reg. at 59,658. Nonetheless, the channels and user interface received on computers, tablets, and phones are fundamentally similar for all subscribers and almost identical for most subscribers. Del Beccaro Decl. ¶¶ 31-39. Although for a short time, including at the time of the hearing in this proceeding, there were additional channels available via internet that were not available on the television, that was transitory and driven merely by timing differences in technological implementations: today every channel transmitted via internet is also available on the television. *Id*. ¶¶ 29, 31-32. Even the screen interface today is essentially identical, excepting minor layout differences required by different sized screens, for most subscribers on the television compared to the computer, tablet, and phone. *Id*. ¶¶ 32-37.

1. Mobile access from outside the home does not change Music Choice's internet transmissions into a fundamentally different service.

The Judges' focus on access outside the home in the Final Determination appears to have been based upon a misunderstanding. As demonstrated above, Music Choice's service has always been available outside the home, and the use of the term "residential" in relation to Music Choice's service has – consistent with MVPD industry usage – never designated a restriction or description of the nature or receiving location of Music Choice's music channels, but merely serves to distinguish between the consumer subscribers who receive the service and business – or "commercial" – MVPD subscribers who do not. MVPDs do not have separate "mobile" or "outside the home" subscribers, only residential and commercial subscribers. *See* Del Beccaro Decl. ¶¶ 52-53; 57. In the original CARP proceeding for the PSS, the panel used the term "residential" in this same way: to distinguish between the services' consumer and business subscribers. Trial Ex. 929, CARP Report, ¶ 44 (referencing "residential" cable subscribers), ¶ 46 ("The services also transmit sound recordings to commercial subscribers."). This distinction was

relevant because the background music services provided to commercial subscribers require no public performance license and are not covered by the PSS license. A term with a specific meaning within the MVPD industry should be given that meaning in the PSS regulations, and not a different, colloquial meaning of the term. *See Ass'n of Am. R.R. v. Costle*, 562 F.2d 1310, 1319–22 (D.C. Cir. 1977) (holding that when a term has an established meaning within a regulated industry agency should use the usual and customary meaning of the term in that industry when issuing regulations).

To the extent Music Choice has improved and added features associated with its internet transmissions, particularly with respect to mobile access, these are exactly the kinds of evolutionary changes allowed by an existing service offering. In discussing the leeway given to existing service offerings, the Register noted that a PSS could adapt even to totally different technology used in that transmission medium without losing PSS status and that the key is looking at whether the applicable industry treats the new technology as part of that transmission medium, using the example of the "residential" cable industry:

> For example, an existing service offering that on July 31, 1998, was delivered to residential cable subscribers through coaxial cable, may today be delivered to such cable television subscribers through optical fiber without constituting an expansion to a new "transmission medium" within the meaning of section 114. In other words, this service offering would still be an existing service offering, rather than an expanded service offering or different service offering, because it would still be part of what is traditionally considered to be a residential television service; this is true even though optical fiber may provide certain advantages over coaxial cable.

Register's Ruling, 82 Fed. Reg. at 59,659. In this case, given that its existing service offering included internet the test for Music Choice is whether the improvements and new features are within the industry understanding of an internet service today and internet services are commonly available outside the home – including on mobile devices. Mobile access to Music

Choice's music channels is unquestionably consistent with current industry understanding of the internet as a transmission medium.

Mobile access to Music Choice's music channels is also consistent with current industry norms for "residential" cable and satellite services recognized by the MVPD industry. Music Choice's mobile access improvements have been necessary to adapt to industry-wide standards applicable to all television network programming providers. Within the MVPD industry, TV Everywhere – the availability of television programming outside the home via computer and connected devices such as phones and tablets – has been a widely used and crucial feature of "residential" MVPD services for many years. Del Beccaro Decl. ¶¶ 50-53. The subscribers are still referred to as "residential" subscribers because they are individual consumers, not commercial businesses. But across the cable industry – currently and for a good many years – almost every MVPD has included almost every one of its carried networks and channels on a TV Everywhere basis, including mobile access outside the home. *Id*. ¶ 53.

This access is provided as an integral part of the consumer's television service at no additional charge to the subscriber. In all cases subscribers accessing MVPD content must authenticate their cable or satellite television subscriptions through the MVPD to stream the programming. Internet access may be offered via, *inter alia*, the MVPD's website, the network's website, the MVPD's app, or the network's app. *Id*. ¶ 55. Today many networks have several websites or apps, including websites or apps focused on different types of network content like news or sports, or individual shows like Saturday Night Live, as well as more general network-wide websites and apps. Through these various websites and apps, the MVPDs and networks offer authenticated subscribers streaming access to both live programming and on-demand content. *Id*. ¶ 56. Depending on the MVPD, live streaming (like the Music Choice transmissions

at issue) may not be available outside the home through all of the different methods of access, but it is always available through at least one of these websites or apps. *Id.* If a particular MVPD's own app does not provide live streaming, it will be available via the MVPD's website, the network's website, or one or more of the network's apps. Most MVPDs, however, offer live streaming of most networks both through the MVPDs' and the networks' respective websites and/or apps. *Id.*

Further demonstrating this industry understanding, the FCC (the agency tasked with regulating the cable and satellite television industry) expressly treats such mobile internet transmissions by MVPDs or television programming as part of the company's MVPD service, and different from similar transmissions by non-MVPDs. It recognizes that, "[i]n addition to delivering video programming to television sets, today's MVPDs may choose to deliver video programming to computer screens, tablets, and mobile devices." *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming – Seventeenth Report* at ¶ 16, MB Docket No. 15-158, Federal Communications Commission (May 6, 2016) , *available at* https://docs.fcc.gov/public/attachments/DA-16-510A1_Rcd.pdf . When those cable and satellite television companies provide access outside the home, such access is treated by the FCC as part of their Multichannel Video Program Distributor offerings, and differently from other types of companies providing video programming via the internet, which it calls Online Video Distributers, or OVDs. *Id.* at ¶ 1 n.4. Thus, the FCC recognizes that cable and satellite television providers may provide their subscribers with access to their programming (including Music Choice's cable and satellite television channels) outside the home via internet transmissions, as an integral part of their "residential" cable and satellite services, not as a different, OVD service.

The only differences between Music Choice's service delivered via internet now versus 1998 reflect service enhancements attributable to improvements and changes to internet technology and mirror the features and functionality used by other internet services and other channels available to consumer MVPD subscribers. These changes do not alter the fundamental nature of the service, which remains a bundle of non-interactive digital music audio channels delivered to consumer television programming subscribers.

2. There is nothing about delivery via an "app" that fundamentally changes the nature of Music Choice's internet transmissions

Similarly, the fact that Music Choice has developed "apps" for mobile devices since 1998 does not change the fundamental nature of the service. First, an "app" is not a different medium of transmission, nor is it a different service. With respect to Music Choice's mobile apps, the medium of transmission is the same internet used to transmit to desktop or laptop computers since 1996, and even certain televisions today. Del Beccaro Decl. ¶ 60-63.

Second, the term "app" is merely a shortened version of the term "software application." A software application is an executable computer program that performs a function. Nothing more and nothing less. Del Beccaro Decl. ¶ 61. Music Choice's mobile apps do not create or propagate the transmissions; they are merely software applications that provide the interface for users to listen to the music channels. But the use of apps to receive Music Choice's music channels is not unique to access outside the home, or even unique to its internet transmissions. Software applications are required to listen to Music Choice anywhere and everywhere, and on all platforms. Even listening to Music Choice on a television requires a software app. There is no way for subscribers to listen to the Music Choice channels without Music Choice creating an app for that purpose. *Id.* ¶ 62.

Nor is delivery via an app a new feature of the Music Choice service. *See id.* ¶¶ 62-63.

Music Choice has always had to develop, and has *always* utilized software applications to deliver its service, regardless of whether transmitted by television signal or by internet. *Id.* ¶ 62. Music Choice's first software apps were created well before the DMCA was enacted. When it created its original, stand-alone cable box solely to receive the Music Choice service, it had to create an app to run on that box so that subscribers could receive and select the channels. *Id.* ¶ 63. When Music Choice moved to providing the service through the MVPDs' general purpose set top boxes, it had to create apps that could run on those boxes (which are a type of special purpose computer device just like tablets and smart phones are) to enable subscribers to interface with the service. *Id*. When it first launched the cable modem and other internet-based access features for the service in 1996, consumers had to use apps to interface with the channels, whether the app was a web browser or a special purpose application installed on their computer to access the channels via web servers. *Id*.

The costs of all these pre-DMCA technological developments were among the investments that the DMCA sought to recognize and protect with the PSS designation. And these investments were foundational to all future continued investments in the same service lines. Del Beccaro Decl. ¶ 64. Nor is Music Choice's internet offering the only element of its service that has evolved to keep up with marketplace trends and consumer expectations. As television technology has changed and improved over the years, Music Choice has constantly updated and created new apps to adapt to those new technologies and to improve the subscriber interface. *Id*. It could not have continued to have a viable service without being able to develop organically in this fashion, as Congress intended us to do when it created the PSS category in the DMCA.

There are simply no grounds to find that Music Choice's internet transmissions – which it has been making since 1996 – are anything but existing service offerings, eligible for the full,

unconditional grandfathered rates and terms of the PSS license.

III. SoundExchange Has Not Carried Its Burden to Show That Any Changes to the Audit Provision Are Justified.

SoundExchange – the proponent of the disputed change to the defensive audit provision applicable to the PSS – has identified no justification for departing from the longstanding practice of permitting PSS licensees to engage in proactive, independent audits that will fully satisfy the royalty payment verification interests of royalty recipients. Its proposed change should be rejected.

A. SoundExchange Has Not Provided Justification for Changing the Longstanding Regulation Permitting PSS to Protect Themselves Through Defensive Audits.

The "defensive audit" provision was implemented to protect services from disruptive, expensive and burdensome audits by the Collective, while still protecting royalty recipients' interests in accurate and timely payments. As the D.C. Circuit recognized, that provision has long operated as "a kind of safe harbor for preexisting services like Music Choice.'" *Music Choice*, 970 F.3d at 428–29.

The history of the defensive audit provision shows why this safe harbor was – and remains – needed. In the very first CARP proceeding, the CARP implemented the defensive audit provision – at Music Choice's request – to provide a fair balance of the parties' legitimate interests. The CARP recognized the importance of requiring that these royalty verifications be conducted by independent and qualified auditors, pursuant to generally accepted auditing standards. Such requirements, which are governed by neutral, widely-understood standards promulgated by the American Institute of Certified Public Accountants ("AICPA"), are essential to ensuring that the royalty payment audits, irrespective of who conducts them, are fair and objective. Trial Ex. 979 (CARP Report) at ¶¶ 191 (to have access to licensee's confidential

information necessary to conduct royalty payment audit, collective must use an independent and qualified auditor), 194, 210; *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings*, Docket No. 96-5 CARP DSTRA, May 8, 1998, 63 Fed. Reg. at 25,414-15.

The defensive audit provision protects licensees by ensuring that the audit process will not be unduly disruptive, costly or harassing. As the D.C. Circuit noted, "in 1997, when CARP and the Librarian of Congress, the Board and Register's predecessors, created the defensive audit procedures, CARP stated that allowing the preexisting services to conduct their own audits rather than being subject to outside copyright owner audits would balance the 'fair opportunity to audit for copyright owners' against 'the burden and expense of auditing upon the Services.'" *Music Choice*, 970 F.3d at 428–29, quoting *Copyright Arbitration Panel*, Report No. 95-5 ¶ 194 (Nov. 12, 1997) (adopted 63 Fed. Reg. 25,394 (May 8, 1998)).

By requiring defensive audits to proceed by the same standard – requiring the use of independent, qualified auditors pursuant to GAAS – this provision also protects the interests of the Collective and royalty recipients. The Judges recognized the importance of these requirements in this proceeding – irrespective of which party is conducting the audit – by adopting clarifying language in the definition of "Qualified Auditor," expressly linking the independence requirement to the AICPA Code of Professional Conduct, which sets the independence standard applicable to all CPAs "when providing auditing and other attestation services." *See* Final Determination, 83 Fed. Reg. at 65,261; AICPA Code of Professional Conduct, 0.300.050.01 http://pub.aicpa.org/codeofconduct/resourceseamlesslogin.aspx?prod=ethics&tdoc=et-cod&tptr=et-cod0.300.050. Indeed, SoundExchange has acknowledged in this proceeding that

the regulations have always required its royalty audits to be performed by a CPA, bound by the ethical and other standards of AICPA including the requirement of independence. Docket No. 4734, SoundExchange *et al*. Corrected Proposed Findings of Fact and Conclusions of Law, p. 906-07, SEPFF2282, 2287 (characterizing express independence requirement in definition of Qualified Auditor as "redundant" in light of CPA requirement, which implicitly includes AICPA standards).

An audit that is truly independent (as is required by the regulations and defined by AICPA) serves all parties. The AICPA Code of Professional Conduct defines independence as consisting of two elements: (1) independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism; and (2) independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised. AICPA Code of Professional Conduct, 0.400.21 (need address/location). An audit that meets this criteria is most likely to be objective and non-partisan, and to reach a fair conclusion.

Not only do regular defensive audits save the services time and resources defending SoundExchange's audits; they also benefit royalty recipients. Defensive audits permit the licensee to identify inadvertent underpayments or late payments long before they would be found by a SoundExchange audit. This means that such errors can be corrected – and payment passed along to record companies and artists – sooner and at the licensee's own expense. Indeed, in the

handful of instances in which Music Choice's auditors have determined, in the course of conducting defensive audits, that there had been any underpayment, Music Choice itself proactively made corrective payments to SoundExchange. Potts Decl. ¶ 35.

B. SoundExchange's Misconduct During Its Own "Audits" Demonstrates Why the Defensive Audit Provision Remains Necessary to Protect the Services.

Although the need for defensive audit protection was only hypothetical at the time the first PSS regulations were issued, SoundExchange's abuse of the audit process from its first audit of Music Choice demonstrates exactly why the defensive audit provision is necessary. As Music Choice has discovered, SoundExchange's "audits" are not audits at all, nor do they in any way satisfy the regulations' requirements – despite SoundExchange's representations. The vexatious behavior described below was neither an accident nor an anomaly. In both instances, SoundExchange engineered the entire process to be the antithesis of the independent, objective, and accurate audit required by the regulations. And it continues to employ these tactics today.

1. SoundExchange's use of partisan forensic accountants in 2005

In 2005, SoundExchange commenced its first audit of Music Choice's PSS royalty payments, for 2001 through 2003. At that time, Music Choice had not yet availed itself of the defensive audit right. But during the course of that process, SoundExchange's conduct (and that of the accounting firm it hired – RZO LLC) was so outrageous, unduly disruptive, and burdensome that Music Choice subsequently began paying for its own proactive audits – and has continued to do so ever since. Potts Decl. ¶¶ 28-29.

Both in its notice of audit and other communications, SoundExchange represented that it would be conducting an "audit" consistent with the PSS regulations. But RZO did not conduct an independent audit as those terms are understood by CPAs and AICPA. *See* Potts. Decl. ¶ 17. As a preliminary matter, there is no reference to an "audit" in RZO's report – which is instead titled

a "royalty examination." *See* Potts Decl. ¶ 17, Ex. MC 3 (RZO's "Royalty Examination" report). In that report, there is also no attestation language, nor any statement that RZO complied with any particular standards, much less GAAS. This omission alone is proof of non-compliance with GAAS, which require the report associated with an independent audit to use the word "independent" in the title and to state its compliance with GAAS within the report. AU-C §700.22, AU-C §700.28. https://www.aicpa.org/research/standards/auditattest/downloadabledocuments/au-c-00700.pdf. What RZO conducted – a forensic accounting "examination" – is not an audit, and falls far short of what is required by the regulations.

Not only was this not an "audit," the two individuals involved – Mr. Resnick and Thomas Cyrana – were not "independent auditors." Mr. Resnick could not ethically conduct an audit due to his lack of independence, as discussed further below. Mr. Cyrana does not appear to even be a CPA. *See* Potts Decl. ¶ 18, Ex. MC 4. Mssrs. Resnick and Cyrana are not qualified auditors, as that term is understood by CPAs and AICPA. Instead, they appear to focus on forensic accounting consultation and other non-attest work, which is fundamentally different from audit and other attest work and is governed by totally different professional standards that do not require independence.

To the contrary, AICPA consulting standards require the opposite of independence: that the consultant represent the client's specific interests and objectives, a requirement inconsistent with independence as that term is defined by AICPA. *Id.* ¶ 18. There is a crucial difference between an audit (which includes an "attestation" accounting function, requiring strict independence on the part of the auditor) and a work done under the AICPA "consulting standards." *See* Potts. Decl. ¶ 18. The latter does not satisfy the requirements of the regulations;

but it is the latter that SoundExchange has always done – and continues to do to this day. Music Choice had no way of knowing this at the time it allowed RZO access to its business records, but the very engagement agreement executed by SoundExchange and RZO clearly demonstrates that RZO was not hired to exercise independence nor to conduct an audit pursuant to GAAS. Declaration of Margaret Wheeler-Frothingham ¶ 2, Ex. MC 16, RZO Engagement Agreement, p.2 ("[[ ]]").

But SoundExchange's misconduct went even farther, failing to disclose the extent of its accountant's lack of independence. SoundExchange initially disclosed to Music Choice that some of the principals of RZO had some unspecified ownership interest in certain sound recordings. Potts Decl. ¶ 15. SoundExchange assured Music Choice that if Music Choice waived that conflict, the particular individuals would not be significantly involved in the work of the audit. In an attempt to be cooperative, Music Choice agreed to waive that conflict, under those terms. *Id*. But at least one of the conflicted accountant worked directly on the audit, despite the parties' agreement. *Id*. ¶ 16.

Worse, although SoundExchange sought Music Choice's waiver of certain conflicts arising from music copyright ownership interests at RZO, it failed to include on that list of conflicts any disclosure that one of the principals had interests far beyond mere ownership in music copyrights. *Id*. That accountant, Perry Resnick, was in fact a SoundExchange board member from 2003 through 2018 – a conflict that goes far beyond merely having an attenuated financial interest in music royalties in general. *Id*. ¶ 16, Ex. MC 2. In no way was Mr. Resnick

"independent" such that his investigation would meet the regulatory or accounting requirements for an audit.

Under AICPA's Code of Professional Conduct, a CPA violates his independence obligations by providing audit services to an entity if he participates in the management of that client, including specifically by board service. Potts Decl. ¶ 16; AICPA's Code of Professional Conduct 1.275.005 http://pub.aicpa.org/codeofconduct/resourceseamlesslogin.aspx?prod=ethics&tdoc=et-cod&tptr=et-cod1.275. Under the AICPA ethics rules, such a conflict cannot be waived. AICPA's Code of Professional Conduct 1.110.010.03 http://pub.aicpa.org/codeofconduct/resourceseamlesslogin.aspx?prod=ethics&tdoc=et-cod&tptr=et-cod1.110.

Moreover, the aggressive posture SoundExchange took based on the findings of its accountants in that verification reinforces why the PSS must be allowed to protect themselves from SoundExchange's abuse of the audit right. At the conclusion of that partisan examination, RZO took many false positions of claimed underpayments premised on unreasonable misinterpretations of the PSS regulations. Many of the claimed underpayments were based upon revenue that Music Choice never actually received. For example, there were some instances where Music Choice had the contractual right to charge certain affiliates interest on late payments in its own discretion, but did not actually receive any interest payments. Potts Decl. ¶ 21. RZO took the position that Music Choice was required to include in its Gross Revenue for PSS royalty computation purposes any revenue to which it was legally entitled, even if it never actually received such revenue. *Id*. This is flatly wrong. Gross Revenues only include monies actually received, including bad debts actually recovered. 37 C.F.R. § 382.11.

RZO also claimed underpayments based upon revenue that was not derived from actually providing the PSS to subscribers. For example, Music Choice obtained a breach of contract payment in a bankruptcy proceeding for one of its affiliates based upon that affiliate's early termination of the service. Potts Decl. ¶ 22. But Gross Revenues only include revenues received "from the operation of the programming service of the licensee." 37 C.F.R. § 382.11.

RZO also used improper extrapolation methods, inconsistent with GAAS. For example, RZO identified an underpayment in one single month that was caused by an Excel spreadsheet formula error in the spreadsheet for that month's statement. RZO then extrapolated that error out to all the other months that it did not test, even though Music Choice provided the spreadsheet data showing the formula error was not repeated in those other months. Potts Decl. ¶ 23. That improper extrapolation alone added [[ ]] to RZO's claims, by far the largest single underpayment claim in the Report. *Id.*

Based in large part upon these various improper claims, the RZO Examination Report purported to identify a total of [[ ]] in claims, including underpayments, interest, and reimbursement of audit fees, more than half of which comprised the underpayments improperly extrapolated from one spreadsheet error and associated interest. *Id.* ¶ 24. Music Choice engaged with RZO to dispute and discuss the alleged underpayments, and verified that there were approximately [[ ]] in legitimate accounting errors and interest on those errors. Notably, Music Choice also found during this process a number of overpayments to SoundExchange during the same periods, which RZO did not find in its examination. *Id.* ¶ 26. With respect to the valid accounting errors, Music Choice promptly agreed to pay the associated amounts and tendered payment in full for those errors and associated interest in the amount of [[ ]]. *Id.*, Ex. MC 6.

After Music Choice tendered this payment, it continued to dispute the validity of the remaining claims, providing detailed refutations. Eventually, over four years after RZO began its "examination," SoundExchange agreed to settle the disputed claims – [[ ]]. *Id.* ¶ 27, Ex. MC 7.

2. SoundExchange's continued use of partisan forensic accountants in 2017

Even today SoundExchange does not conduct "audits" or engage accountants that are either independent or undertaking their work pursuant to GAAS. This is confirmed by the facts surrounding SoundExchange's most recent royalty verification.

SoundExchange sought to begin another "audit" of both Music Choice's PSS and its BES in 2017. Potts Decl. ¶ 37. Relying on the defensive audit provisions in the PSS regulations, Music Choice tendered the audit reports of the independent auditors at BDO, and took the position that SoundExchange could only conduct its own audits for Music Choice's BES for the periods at issue. *Id.* ¶ 38.

SoundExchange requested that Music Choice provide the final BDO PSS audit reports to the Prager Metis accountants, give them direct access to the BDO accountants who conducted those audits, and provide various working papers generated during the audits so that Prager Metis could evaluate the sufficiency of those audits. Music Choice complied with these requests. *Id.* ¶ 39. BDO answered numerous questions posed by Prager Metis, participated in on-site meetings with Prager Metis, and provided various backup and working papers requested by Prager Metis. In March of 2018, Prager Metis informed Music Choice that it did not need any additional information from BDO for its evaluation of the defensive audits and requested to begin the field work only for the BES royalty examination. *Id.* ¶ 40.

At no point did Prager Metis or SoundExchange identify to Music Choice ***any*** alleged

error, problem, or insufficiency in BDO's audits. Nor did SoundExchange or Prager Metis seek to perform their own audit of the PSS royalty periods covered by the BDO audits after Prager Metis concluded its investigation. *Id.* ¶ 41. Instead, Prager Metis simply proceeded to conduct an examination limited to the BES royalty payments, and eventually issued a report on that examination similarly limited to the BES royalty payments. *Id.*

When Prager Metis provided its report on the BES royalty payments in connection with its 2017 investigation, it became clear that (1) Prager Metis did not exercise independence; (2) Prager Metis did not conduct an audit, as that term is understood by CPAs and AICPA; and (3) Prager Metis did not comply with GAAS. *Id.* ¶ 43.

First, similar to the RZO accountants used in 2007, the Prager Metis accountant who ran the 2017 process for SoundExchange is a forensic accountant – not an auditor. Although Prager Metis has an independent audit group, Mr. Lewis Stark does not appear to work with that group but rather is part of the "Royalty Audit & Contract Compliance" group: This group's webpage states, "Our royalty compliance services are also designed to present the licensor's position regarding how the agreement should be interpreted and fix reporting errors resulting in monetary recoveries and increased payments going forward." Potts Decl. ¶ 46. This describes not independence, but rather a partisan, forensic examination with a goal of maximizing claims of underpayment by promoting SoundExchange's most aggressive positions on interpreting the BES regulations. This is the antithesis of independence. *Id.*

Second, with respect to the BES royalty payments, Prager Metis did not perform an "audit" at all. The Prager Metis report submitted in connection with the 2017 verification expressly disclaims having conducted an audit or otherwise complying with GAAS. Instead, the report makes clear the

]] *Id.* ¶ 44. But those AICPA Consulting Standards do *not* require independence. As noted above, they require the opposite: the consulting CPA has an ethical obligation to "…Serve the client interest by seeking to accomplish the objectives established by the understanding with the client…". STATEMENT ON STANDARDS FOR CONSULTING SERVICES 100.07 https://www.aicpa.org/interestareas/forensicandvaluation/resources/standards/downloadabledocuments/sscs.pdf.

Also similar to RZO, Mr. Stark's engagement agreement with SoundExchange (he was at EisnerAmper at the time) confirms the firm's lack of independence and failure to follow GAAS. Wheeler-Frothingham Decl. ¶ 3, Ex. MC 17, p. 1 ([[

]]). Thus, its so-called "examination" was not an audit, was not conducted by an independent, qualified auditor, and was not conducted pursuant to GAAS.

C. Soundexchange Has Not Identified Any Way in Which Music Choice's Defensive Audits Are Insufficient

As noted above, after the 2005 RZO "audit," Music Choice began proactively commissioning truly independent audits of its PSS royalty payments, beginning with 2008 and continuing for every year ever since. Potts Decl. ¶ 29. In every instance, Music Choice has retained an independent audit firm with qualified CPAs with significant experience conducting audits pursuant to GAAS. In each year, Music Choice retained the same firm it used for its company financial audits so that the auditors would already be familiar with Music Choice's business operations and accounting systems, but pursuant to a separate agreement. Because both engagements involve true audit services, they are subject to the same duty of independence and

objectivity. *Id.* ¶¶ 30-31. The end result of each audit has always been a written independent auditor's report, including the auditor's formal opinion that Music Choice's schedule of royalty payments was accurate.

As independent auditors under the AICPA ethics rules and GAAS, the auditors use their own independent judgment to develop the best methodology to test the accuracy of Music Choice's payments. Music Choice has no control over the choices and methodologies selected by its independent auditors. Although they review schedules of the payments prepared by Music Choice, they independently test the accuracy of those schedules and investigate the manner in which they were prepared. They also independently determine compliance with the PSS regulations, and do not rely upon Music Choice to interpret them. Potts Decl. ¶ 31.

D. Music Choice's Defensive Audits Are Not Limited in Scope

SoundExchange argues that the "scope" of defensive audits is insufficiently addressed in the current regulations. Specifically, SoundExchange seemingly takes issue with the use of the sampling methodology in defensive audits. Sampling is the process of selecting a subset of the total data within the scope of the audit and testing that subset and extrapolating the results out to the entire dataset. This methodology is commonly used in audits and many other types of accounting work, and is certainly within GAAS. In most instances, it would be wildly inefficient, if not practically impossible, to test all of the data subject to audit. Sampling methodologies have been developed to allow for efficient but accurate audits. Potts Decl. ¶ 20. Part of the independent and objective judgment a CPA must exercise pursuant to AICPA ethics rules and GAAS relates to using appropriate sampling methodology to generate efficiency without sacrificing accuracy. Moreover, SoundExchange's own forensic accountants use sampling when conducting their non-audit "examinations." *Id.* ¶ 21. SoundExchange can hardly claim it is

prejudiced by an independent auditor's standard use of the very same methodology it instructs its own forensic accountants to employ.

The use of sampling should not be misconstrued as somehow limiting the "scope" of the audit. The scope of every audit commissioned by Music Choice encompasses the entirety of Music Choice's payments for the PSS license in a given year, and the auditor's resulting opinion covers the entirety of those payments – irrespective of the sampling approach commonly used. *Id.* ¶ 33.

If given credence, SoundExchange's position on the "scope" of an audit would effectively destroy the defensive audit provision because all audits use sampling. Under that view any sampling would render a defensive audit incomplete and allow SoundExchange to conduct its own audit for the same rate period. This would defeat the entire purpose of the defensive audit. Adding to the absurdity of this result, SoundExchange's own duplicative audit would also use sampling. In short, SoundExchange has provided no real justification for its proposed change, so there is no basis for implementing it. That change must be rejected. At the very least, the proposed new language would need to be clarified to expressly state that the use of sampling and other methodologies consistent with GAAS do not change the scope of the audit.

CONCLUSION

For the reasons set forth above, Music Choice respectfully requests that the Judges determine that Music Choice's internet transmissions are within the scope of the PSS license and that no modification to the defensive audit provision is warranted and strike the following language previously added to the applicable regulations: (1) the final sentence in the Preexisting Subscription Service definition in 37 C.F.R. § 382.1 and (2) "with respect to the information that is within the scope of the audit" from 37 C.F.R. § 382.7(d).

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Respectfully submitted,

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Proof of Delivery

I hereby certify that on Thursday, July 01, 2021, I provided a true and correct copy of the Music Choice's Opening Remand Brief to the following:

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Recording Industry Association of America, represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

Sirius XM, represented by Todd Larson, served via ESERVICE at todd.larson@weil.com

American Federation of Musicians of the United States and Canada, represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

Signed: /s/ Paul Fakler