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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)

DECLARATION OF RUSSELL POTTS
IN SUPPORT OF RESPONSIVE BRIEF ON REMAND

1. My name is Russell Potts and I am Music Choice’s Senior Director, Financial Analysis. I submit this Declaration in support of Music Choice’s Responsive Brief in connection with the Remand in the SDARS III proceeding. I am fully familiar with the facts set forth in this Declaration, including based upon my review of Music Choice business records and discussions with other Music Choice employees, and if called upon to further testify could do so truthfully and competently.

**SoundExchange’s Complaints Regarding Music Choice’s
Defensive Audits Have Nothing to Do With the “Scope” of Those Audits**

2. Music Choice’s audits of its PSS royalty payments, including the audits conducted by BDO and discussed by Mr. Stark in his testimony, have always been conducted by qualified independent auditors pursuant to Generally Accepted Auditing Standards (“GAAS”) as promulgated by the American Institute of CPAs (“AICPA”).

3. GAAS has specific rules relating to the scope of an audit. For a given financial statement or schedule being audited, the scope of the audit is the entirety of the financial data

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described in the statement or schedule. The entire financial statement or schedule is within the scope of the audit. As I noted in my prior testimony, auditors routinely use sampling methodologies to test the accuracy of a financial statement, but the use of such methodologies does not limit or otherwise change the scope of the audit.

4. Thus, with respect to Music Choice's defensive audits, the entirety of Music Choice's PSS royalty payments are reflected on the schedule subject to the audit and therefore the scope of those audits includes all of Music Choice's PSS royalty payments for that year and therefore within the scope of the auditor's opinion.

5. GAAS specifically provides that if the management of the audited company attempts to limit the scope of the audit, the auditor must request that the company remove that limitation. AICPA's Clarified Statements on Auditing Standards AU-C §705.11. If the company does not remove the limitation on scope and there is no other way to avoid the limitation, the auditor must either issue a qualified opinion expressly noting any limitation on the scope of the audit or withdraw from the engagement. *Id.* at AU-C §705.13.

<https://www.aicpa.org/research/standards/auditattest/downloadabledocuments/au-c-00705.pdf>

6. Music Choice's auditors have never issued a qualified opinion with respect to the defensive audits, nor have they ever withdrawn from the engagements. Given all this, even if SoundExchange's complaints were well-founded they would not support the change to the regulations it seeks. But those complaints are not well-founded.

**BDO and Music Choice Fully Cooperated
with Mr. Stark's Investigation of the BDO Audits**

7. SoundExchange and Mr. Stark allege that Music Choice and BDO refused to cooperate with Mr. Stark's investigation of the BDO audits, including by refusing to provide

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copies of “most” of the work papers and instead only allowing Mr. Stark and his team at Prager Metis to view a limited subset of those papers on a computer screen, supposedly at Music Choice’s offices. Stark Decl. at ¶ 8. These allegations are untrue.

8. As I explained in my earlier testimony, Mr. Stark and his team were provided with access to BDO’s audit reports, working papers, and the BDO auditors themselves. First, Music Choice answered various preliminary questions submitted by Prager Metis and had a phone conference to discuss those preliminary questions. At Mr. Stark’s request, there was a full day set aside for meetings with the BDO auditors to review the work papers and ask any questions. Notably, this meeting took place at BDO’s offices, not Music Choice’s as Mr. Stark claims. Mr. Stark stated that he did not believe his team needed more than a day but would return the next day if necessary. Music Choice helped coordinate the meeting at BDO’s offices and had a representative present. A BDO representative was also present at the meeting. Attached hereto as **Exhibit MC 18** is a true and correct copy of a chain of email correspondence between Mr. Stark and Music Choice, discussing these matters (arranging call for preliminary questions, p. 3; Mr. Stark indicating one day would likely be sufficient for work paper review at BDO’s offices, p. 2).

9. At the meeting at BDO’s offices on October 9, 2017, Prager Metis was allowed to review BDO’s work papers on BDO’s computers. This is a standard process for doing auditing fieldwork, especially when sensitive accounting records are involved. At no time did Prager Metis complain about this process. The BDO accountants were also available to answer any questions the Prager Metis team had. Neither Music Choice nor BDO refused to answer any questions about the work papers or the BDO audit reports. In connection with the October 9 meeting, Prager Metis sent BDO written questions based upon its review of the work papers, and

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BDO responded to those questions. Attached hereto as **Exhibits MC 19 and MC 20** are true and correct copies of the email chains from October 9, 2017 with the questions and answers.

10. Prager Metis did not request a second day at BDO's offices. It did request copies of certain of the work papers, and also asked some additional follow-up questions. BDO responded to those additional questions and provided pdf copies of the work papers. There were only two documents requested by Prager Metis that BDO did not provide. Those were the 2014 and 2015 "cash reconciliation" papers. These were not provided because they were not relied upon by BDO in issuing its opinion on the PSS royalty payments. Those papers were not relevant to the PSS royalty payments because they reconciled to GAAP "revenue," which is different from "Gross Revenue" as defined in the PSS regulations. Attached hereto as **Exhibit MC 21** is a true and correct copy of an email chain including the follow-up questions and answers, and BDO's provision of copies of the work papers to Prager Metis, along with the work paper attachments.

11. After BDO provided the work papers and answered all of Prager Metis's questions, we never heard back from Mr. Stark or his team. Music Choice followed up with Prager Metis on October 25, 2017 to see if it needed anything further from BDO. Prager Metis acknowledged receipt and said it would get back to us soon. We heard nothing further from Prager Metis until March 1, 2018, at which time Mr. Stark responded to Music Choice's email, saying "We are ready to proceed with the phase of our examination. At this time, we do not need anything else from BDO. We may need more information from you and BDO or may perform additional procedures at a later date. We do want to start the examination of your BES and webcasting services." Attached hereto as **Exhibit MC 22** is a true and correct copy of this email chain. At no point, before or after this email, did Mr. Stark or Prager Metis identify any

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deficiencies in BDO's audits, request any additional information, or seek to perform any additional procedures with respect to Music Choice's PSS royalty payments.

12. Mr. Stark also complains that Music Choice refused to produce audit reports or other information about its 2013 PSS royalty payments. This was because SoundExchange did not begin its proposed audit of Music Choice until well into 2017 and the PSS regulations only allow SoundExchange to go back three years from the commencement of the audit. After Music Choice took this position, SoundExchange added 2016 to the audit notice (SoundExchange had initially sought to audit 2013 through 2015) and Music Choice provided its defensive audits for the previous three years of 2014 through 2016, as the regulations provide.

13. Mr. Stark's testimony in this proceeding that Music Choice failed to cooperate with his investigation of the BDO audits is simply and utterly false.

Mr. Stark's Allegations of Deficiencies In the BDO Audits Are False

14. Mr. Stark alleges that BDO provided an opinion regarding conformity with Generally Accepted Accounting Principles ("GAAP"). This is untrue, and I have no idea why he would say that. As clearly stated in the audit reports, BDO's opinion evaluated the accuracy of Music Choice's PSS payments in conformance with the applicable PSS regulations, which are distinct from GAAP.

15. Mr. Stark complains that the BDO audits "only" provide "opinions" of the BDO auditors that Music Choice's statements of PSS royalty payments were "presented fairly in all material respects." He first claims that such an opinion does not go to the accuracy of the statements. This is simply untrue. Pursuant to GAAS, the very purpose of the opinion that the audited statements are presented "fairly" is to establish accuracy. In BDO's audit reports, in the

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description of the auditor’s responsibility, it clearly states the purpose of the audit is to determine whether the schedule of PSS payments is “free from material misstatement.” And auditors perform testing sufficient to establish the accuracy of the statements. Perhaps Mr. Stark has his own “colloquial” definition of “accuracy” – like his “colloquial” definitions of “audit” and “independent” – which means something different than free from misstatement. But a CPA performing his or her duties under GAAS certainly understands that they are testing the audited statements for accuracy. That testing is the basis of the opinion and is reflected in BDO’s work papers, which were reviewed and provided to Mr. Stark and his team.

16. Mr. Stark next notes that the audit opinion includes a materiality component, and complains that the materiality standard is not explained in the audit reports. But the materiality standard is part of GAAS and is well known by CPAs. It requires an independent auditor to use professional judgment to determine whether any misstatement found would influence the judgment of a reasonable user of the audited statements. AU-C §320.02

<https://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00320.pdf>. I note that in his non-GAAS examinations, Mr. Stark also uses his judgment – though not independently – to employ methodologies such as sampling that inherently may not result in every single error or misstatement being reported. The fact that Mr. Stark seeks to perform a duplicative examination of the same royalty statements solely to try to uncover **immaterial** errors, which would not even influence the judgment of a reasonable user of the statements, demonstrates why the defensive audits are necessary.

17. Mr. Stark also claims that because of this materiality standard, minor errors that are immaterial are not disclosed in the audit reports, going so far as to allege that the standard “prohibited [BDO] from presenting schedules that showed any discrepancies they found.” He is

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flatly wrong. One of the very BDO audit reports he investigated, for the 2015 royalty payments, expressly reported an underpayment of [[REDACTED]] for interest owed on a late payment. Due to finding this error, Music Choice promptly paid the unpaid interest. That was the only underpayment found for 2015, in which year Music Choice paid over [[REDACTED]] in PSS royalties to SoundExchange. Thus, even in the audit reports, the materiality standard does not lead to the concealment of even immaterial underpayments. Nor does Mr. Stark explain why such errors would not be reflected in the auditors' work papers, even if they had been left out of the audit report. Attached hereto as **Exhibit MC 23** is a true and correct copy of the 2015 BDO audit report (noting the underpayment on page 6, note 2).

18. Mr. Stark next claims that BDO did not identify what gross receipts were included or excluded from the royalty calculations and did not assess whether Music Choice accurately interpreted the PSS regulations or any allocation of revenue employed in the calculations. Again, he is simply wrong. The work papers provided to Prager Metis disclose that in testing the accuracy of the royalty statements BDO independently verified the accuracy and completeness of gross revenues related to the PSS, assessed the payments' compliance with the applicable regulations, and fully disclosed the methodology for any allocations of combined payments for PSS and non-PSS services. *See, e.g.,* Ex. MC 21-B, Attachment titled "Updated 2014 Cash Receipts Testing." Moreover, even if that particular information had not been disclosed in these work papers, Mr. Stark could have simply asked the BDO auditors, who answered multiple rounds of specific questions posed by Prager Metis. *See* Exs. MC 19-21.

19. In another attempted distraction, Mr. Stark notes that BDO initially proposed a different scope of work when first engaged, similar to the type of examination procedure employed by Mr. Stark and that Music Choice rejected that proposal. This is true, but proves the

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opposite of what Mr. Stark argues. BDO's initial proposal, just like Mr. Stark's process, would not have satisfied the PSS regulations' audit requirements. It would not have been an audit pursuant to GAAS and would not have carried with it the duty of independence. Music Choice insisted upon the superior – and required – independent full audit pursuant to GAAS, which BDO ultimately performed. Contrary to Mr. Stark's insinuation, this is a more rigorous process, not a less rigorous one. In fact, after Music Choice made clear that it needed BDO to do a full independent audit pursuant to GAAS, BDO noted that it would need to perform additional testing to meet that standard. Attached hereto as **Exhibit MC 24** is a true and correct copy of an email from BDO, informing Music Choice that it needed to perform additional testing to meet the requirements insisted upon by Music Choice.

20. Similarly misleading is Mr. Stark's claim that Music Choice has failed to cooperate with him in connection with a currently noticed SoundExchange audit for 2017 through 2020. As a preliminary matter, Sound Exchange is only allowed to audit three years, so any attempt to audit four years is obviously improper. More important, due to Mr. Stark's obvious failure to satisfy the independence, audit, or GAAS requirements in his prior engagements, Music Choice asked SoundExchange and Prager Metis for assurances that any new audit will comply with those requirements and to explain how Mr. Stark will be qualified to do that. Music Choice raised these questions in April of 2021. Music Choice received no response, so we followed up with SoundExchange and Prager Metis on June 1, 2021. We did not receive any response until July 22, 2021, when SoundExchange provided an incomplete response to our concerns and proposed delaying resolution of the issue until after this remand is decided. So for Mr. Stark to characterize Music Choice as uncooperative when it is he and SoundExchange who delayed for months any response to Music Choice's legitimate concerns is disingenuous.

**The “Additional Steps” Mr. Stark Would Have Taken Had Either
Already Been Done By BDO or Are Irrelevant to Auditing the PSS Payments**

21. As a preliminary matter, I want to reiterate that in no way would Mr. Stark’s preferred process satisfy the PSS regulations. He does not conduct independent audits pursuant to GAAS, and he fails all three of those requirements. In his testimony, he tries to excuse these obvious failures by claiming that his “examinations” are “audits” in a “colloquial” sense of the word. But the terms “independent” and “audit” have very specific meanings to a CPA and under AICPA’s rules and standards. And federal regulations do not use colloquial language, especially when dealing with accounting issues. Those same regulations were recently clarified to expressly reference the AICPA standards in connection with the term “independent.”

22. I note in this regard that the PSS regulation specifically dealing with verification of royalty payments is very clear. In the opening sub-section, it states “General. This section prescribes procedures by which any entity entitled to receive payment or distribution of royalties may verify those payments or distributions **with an independent audit.**” 37 C.F.R. § 382.7. The entire section repeatedly uses the term “audit” to describe the prescribed procedure. It also incorporates the defined term “Qualified Auditor,” which in turn expressly mandates that a Qualified Auditor be independent, as that term is defined by AICPA. 37 C.F.R. § 382.1. This is not a “colloquial” use of the term “independent.” Thus, both the audit and the auditor must be independent, as that those terms are used by AICPA.

23. And AICPA is very clear about what is required of an independent auditor, including that any licensed CPA that holds himself out as an independent auditor must conduct an audit pursuant to GAAS. In the very first paragraph of GAAS, it says: “An independent auditor plans, conducts, and reports the results of an audit in accordance with generally accepted

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auditing standards.” AU §150.01

<https://www.aicpa.org/research/standards/auditattest/downloadabledocuments/au-00150.pdf>.

The AICPA Code of Professional Conduct also requires a CPA performing an audit to follow the relevant standard promulgated by AICPA, ie. GAAS. AICPA Code of Professional Conduct, 1.310.001 <http://pub.aicpa.org/codeofconduct/resourceseamlesslogin.aspx?prod=ethics&tdoc=et-cod&tptr=et-cod1.310.001>. Therefore, even if the PSS audit regulation did not expressly require SoundExchange’s auditor to conduct its audit pursuant to GAAS, such a requirement is necessarily implied by the requirements of an “independent audit” and an “independent auditor.”

24. These distinctions are important. An independent auditor does not represent the interests of the party that engages them. Their obligation is to the public and the truth. The independent audits commissioned by Music Choice did not “leave(s) compliance with statutory license requirements to the discretion of the licensee.” Independent Audits are the gold standard for verifying compliance with any financial requirements. It is routine for independent auditors to be commissioned by the party that is subject to the audit. This is the norm and does not result in “perverse incentives”, “sloppy accounting” or “gamesmanship.” To the contrary, it is precisely the type of forensic accounting engagements under the consulting standard that Mr. Stark does that **require** Mr. Stark to further SoundExchange’s interests and positions, no matter how aggressive and unreasonable.

25. In any event, the “additional procedures” listed by Mr. Stark as those he would have undertaken if allowed to conduct a duplicative “examination” were each either already done by BDO, unnecessary in light of the methodologies used by BDO, or irrelevant to testing the accuracy of the PSS payments pursuant to the applicable regulations.

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26. As can be seen in the BDO work papers and BDO's answers to various questions posed by Prager Metis, See Exs. MC 19-21, BDO had already reviewed and analyzed Music Choice's PSS royalty calculations and the assumptions used to create its royalty statement. BDO also reconciled receipts from its PSS affiliates to the statements of account provided to SoundExchange, including checking Music Choice's general ledger, books of original entry and other supporting documentation to verify reported collections. BDO also evaluated whether Music Choice correctly classified various payments as attributable to its PSS service, and evaluated the reasonableness of any allocations between different services. BDO also reconciled and tested cash receipts and verified the completeness and accuracy of the reported payments. BDO independently evaluated Music Choice's compliance with the PSS regulations and conducted extensive accuracy and completeness tests.

27. With respect to reconciling cash receipts specifically to revenue recorded on Music Choice's trial balance and financial statements, that would not make sense in connection with testing the accuracy of the PSS royalty payments because the regulatory definition of Gross Revenues in the PSS royalty formula is different from the GAAP accounting basis of Music Choice's partnership financial statements. So this procedure would not apply. But BDO did reconcile the reported Gross Revenue to the underlying bank statements and otherwise did any testing necessary to verify that all Gross Revenue was accurately reported. Similarly, Mr. Stark claims he would have done certain "continuity testing" to check on whether all months of revenue from each Music Choice affiliate were reported. But as BDO explained to Prager Metis when it asked about continuity testing, such testing was not necessary because any omissions of specific affiliate payments from cash receipts would have been picked up by the cash receipts testing performed by BDO. Ex. MC 19 (Question 4). BDO found no such discrepancies and

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issued an unqualified opinion. Thus, Mr. Stark's proposed continuity testing would be redundant and unnecessary. Notably, despite already having received this explanation from BDO, Mr. Stark does not provide any explanation of why he believes BDO's methodology would have been likely to miss any unreported payments. In any event, Prager Metis never disputed BDO's explanation at the time, nor did it ever tell Music Choice that the lack of continuity testing was a problem.

28. With respect to determining whether Music Choice "excluded revenue in the same manner as it did for its BES 2015 and 2016 royalties," this similarly makes no sense in connection with the PSS payments. The dispute between the parties regarding the BES payments relates to the fact that BES public performances of sound recordings are completely exempt from copyright and no royalties are due. That license is only necessary for certain ephemeral copies made for those exempt performances and very few of those performances involve the making of additional ephemeral copies, which leads to the need to exclude revenue from performances where no such ephemeral copies are made. That simply does not apply to the PSS. In any event, BDO did evaluate Music Choice's compliance with the PSS regulations, its classifications of revenue, and any apportionments of that revenue in calculating Gross Revenue. Thus, had there been any such exclusion of revenue that would have been found and evaluated by BDO.

29. Moreover, BDO did far more than these "additional procedures." In any event, nothing in Mr. Stark's list of duplicative or irrelevant procedures would have led to any different findings or results, if they were done in an independent manner pursuant to GAAS.

Music Choice Has Not Been Found to Have Significantly Underpaid Royalties

30. Mr. Stark and SoundExchange claim that Music Choice has been found in the past to have significantly underpaid royalties to SoundExchange. This is once again untrue.

31. With respect to the dispute regarding Prager Metis’s examination of Music Choice’s BES payments, as noted above that is almost entirely a dispute about interpretation of the BES royalty formula. It is currently being litigated in federal court and certainly no actual liability findings have been made. Other than that legal dispute, the only actual accounting errors claimed by Prager Metis were two small underpayments, totaling less than [[REDACTED]].

32. SoundExchange further claims in its first audit of Music Choice, its forensic accountants supposedly uncovered a “net liability of more than [[REDACTED]].” This claim is highly misleading. As I explained in my prior testimony, SoundExchange hired one of its own board members to conduct that “independent audit” and the underpayment claims were based almost entirely on absurd misinterpretations of the PSS regulations. There were some small actual accounting errors found, which Music Choice promptly paid. But the vast majority of the initially-claimed amount was ultimately settled for a mere [[REDACTED]]. That SoundExchange continues to characterize this as proof of a [[REDACTED]] underpayment only serves to demonstrate why licensees need to be protected by the requirement of independent, real audits pursuant to GAAS and also be allowed to have such audits done proactively to avoid a similar four-year harassment by SoundExchange.

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33. Pursuant to 28 U.S.C. § 1746, I hereby declare under penalty of perjury that the foregoing is true and correct.

Dated: October 7, 2021
Cherry Hill, New Jersey

A handwritten signature in black ink, appearing to be 'R' followed by a long horizontal line.

Russell Potts

Exhibit MC 18

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Exhibit MC 19

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Exhibit MC 20

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Exhibit MC 21

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Exhibit MC 21-A
2014 Vendor History Testing

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Exhibit MC 21-B

2014 Updated Cash Receipt Testing

RESTRICTED

Exhibit MC 21-C
2015 Vendor History Testing

RESTRICTED

Exhibit MC 21-D
2015 Cash Receipt Testing

RESTRICTED

Exhibit MC 21-E
2016 Vendor History Testing

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Exhibit MC 21-F
2016 Cash Receipt Testing

RESTRICTED

Exhibit MC 22

RESTRICTED

Exhibit MC 23

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Exhibit MC 24

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Proof of Delivery

I hereby certify that on Thursday, October 07, 2021, I provided a true and correct copy of the Declaration of Russell Potts in Support of Responsive Brief on Remand to the following:

SoundExchange, Inc., represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

SAG-AFTRA, represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

Warner Music Group, represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

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

American Association of Independent Music ("A2IM"), represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

Johnson, George, represented by George D Johnson, served via ESERVICE at george@georgejohnson.com

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

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Sony Music Entertainment, represented by Steven R. Englund, served via ESERVICE at senglund@jenner.com

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Signed: /s/ Paul Fakler