

**Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
Washington, D.C.**

In the Matter of:

Digital Performance Right in Sound
Recordings and Ephemeral Recordings

Docket No. 2009-1
CRB Webcasting III

TESTIMONY OF

BARRIE KESSLER

Chief Operating Officer, SoundExchange, Inc.

September 2009

Written Direct Testimony of Barrie Kessler

I. Background and Qualifications

I am the Chief Operating Officer of SoundExchange, Inc. (“SoundExchange”). I have held this position since July 2001. Before I became Chief Operating Officer, I served as SoundExchange’s Senior Director of Data Administration, beginning in November 1999. Prior to that, I worked as a database and technology consultant for the Recording Industry Association of America, Inc. (“RIAA”) for seven years. There, I developed the software for the certification system for Gold, Platinum and Multi-platinum record sales, and created the royalty distribution system for the Alliance of Artists and Recording Companies (“AARC”). I also previously served as Director of Systems for RSA, Inc., where I directed project teams that provided analytical and application design systems to corporate clients, and was responsible for the company’s network administration. I also previously worked as a database consultant for Price Waterhouse and DOC Computer Center.

My responsibilities as SoundExchange’s Chief Operating Officer include overseeing the collection and distribution of royalty payments for the performance of sound recordings through the various types of services eligible for statutory licensing, including the services at issue in this proceeding. In this capacity, I supervise SoundExchange staff who receive royalty payments from licensees, determine the amounts owed copyright owners and performers, and distribute the royalties to those individuals and entities. Additionally, I oversee SoundExchange’s technical involvement with licensees, manage its budget, and coordinate its systems requirements, development, and testing.

II. Overview

I am submitting this testimony to provide background information about SoundExchange and its operations; to describe SoundExchange's collection and distribution of royalties; to address several challenges that SoundExchange faces; to explain why SoundExchange should be the sole Collective for collecting and distributing royalties under the Section 112 and 114 licenses; to provide information related to the proposed minimum fee; and to support SoundExchange's proposal that the Judges continue the same terms for the statutory licenses as they adopted in the Webcasting II proceeding, with certain modifications.

III. SoundExchange's Collection and Distribution of Royalties

A. Overview of SoundExchange

SoundExchange is a 501(c)(6) nonprofit performance rights organization established to ensure the prompt, fair and efficient collection and distribution of royalties payable to performers and sound recording copyright owners for the use of sound recordings over, among other things, the Internet, wireless networks, cable and satellite television networks, and satellite radio services (hereinafter collectively "services" or "licensees") via digital audio transmissions. SoundExchange is governed by an 18-member Board of Directors that is made up of equal numbers of artist representatives and sound recording copyright owner representatives. Copyright owners are represented by board members associated with the major record companies (four), independent record companies (two), the Recording Industry Association of America (two), and the American Association of Independent Music (one). Artists are represented by one representative each from the American Federation of Musicians ("AFM") and the American Federation of Television and Radio Artists ("AFTRA"). There are also seven at-large artist seats, which are currently held by artists' lawyers and managers (four), an individual artist

(Martha Reeves), and individuals who are affiliated with the Future of Music Coalition and the Rhythm & Blues Foundation.

In Webcasting II, Docket No. 2005-1 CRB DTRA, the Judges designated SoundExchange “as the Collective to receive statements of account and royalty payments from Licensees due under § 380.3 and to distribute such royalty payments to each Copyright Owner and Performer, or their designated agents, entitled to receive royalties under 17 U.S.C. 112(e) or 114(g).” 37 C.F.R. § 380.4(b).

SoundExchange has represented artists and record labels on a vast array of issues, including notice and recordkeeping and rate-setting through the Copyright Royalty Judges’ proceedings, as well as the prior CARP processes. In addition, SoundExchange undertakes a number of measures to protect the interests of artists and copyright owners under the statutory licenses, including by conducting audits of licensees, seeking and obtaining compliance by noncompliant licensees, and engaging in other enforcement and compliance measures. Since its founding, SoundExchange has, on behalf of all artists and record labels, sought the establishment of fair royalties and regulations that enable the prompt, fair and efficient distribution of royalties to all those artists and copyright owners entitled to such royalties.

SoundExchange frequently refers to those record labels and artists who have specifically authorized us to collect royalties on their behalf as “members.” We have approximately 9,700 record label members and 29,000 artist members. We also pay statutory royalties to non-members – copyright owners and artists alike – as if they were also members. In total, we maintain accounts for approximately 11,500 record labels and 41,000 artists, including members and non-members.

SoundExchange has distributed royalties based on billions of webcasting performances. To date, SoundExchange has conducted a total of 33 royalty distributions and has made nearly 150,000 individual payments totaling more than \$250 million. SoundExchange collected approximately \$19 million in statutory webcasting royalties for 2006, \$40 million for 2007 and \$50 million for 2008.

SoundExchange strives to minimize the administrative costs associated with royalty collection and distribution. SoundExchange has 40 full-time staff members. In 2007, based on our audited expenses, our administrative rate was 4.3% of total revenue. In 2008, based on our (as of yet unaudited) expenses, our administrative rate was 5.1% of total revenue. This is a remarkable accomplishment, given the short time that SoundExchange has been in existence and the lower revenue base against which this number is calculated (compared with other U.S. collection societies, which often have overall royalties approaching or exceeding \$1 billion). For comparison purposes, I believe reported administrative costs for the American Society of Composers, Authors and Publishers (“ASCAP”) and BMI are typically higher.

B. Webcasting Licensees

The number of webcasters paying royalties to SoundExchange remains robust – 610 webcasting services paid SoundExchange statutory royalties in 2008. In fact, this number undercounts the total number of webcasters that paid royalties in 2008. Some corporate enterprises (*e.g.*, radio station groups) pay and report in a consolidated manner on behalf of all of their affiliates, while other affiliates of other enterprises pay and report separately for each station or for distinct subsets of stations (for example, on a regional basis). Taking these differences into account, SoundExchange actually receives separate reporting, and in some cases separate

payment, from over 1,400 different webcasting services, accounting for thousands of channels and stations.

The commercial webcasters participating in this proceeding – Live365 and RealNetworks – account for a relatively small portion of the total webcasting royalties paid to SoundExchange. In 2008, the royalties paid by these two parties’ webcasting services represented less than 2.5% of the total webcasting royalties paid to SoundExchange. In 2009, they represent less than 2% of the webcasting royalties paid to date.

By contrast, the royalties paid by the webcasters that have opted into one of the three Webcaster Settlement Act agreements that SoundExchange is submitting as exhibits in this proceeding – the Broadcasters agreement with the National Association of Broadcasters (“NAB”), the Noncommercial Educational Webcasters agreement with College Broadcasters, Inc. (“CBI”), and the Commercial Webcasters agreement with Sirius XM Radio – represent over 50% of the total webcasting royalties paid to SoundExchange in 2008.

C. Royalty Collection and Distribution

SoundExchange’s core mission is to collect and distribute statutory royalties as efficiently and accurately as possible. We have worked hard for nearly ten years to develop sophisticated systems, business processes and extensive databases uniquely suited to the challenging task of distributing statutory royalties. For managing royalty collection and distribution, SoundExchange employs the following operational procedures.

Receipt of Payment. SoundExchange’s Royalty Administration and Distribution Services Departments receive from statutory licensees royalty payments and, ideally, two reports: (1) statements of account that reflect the licensee’s calculation of the payments for the reporting period; and (2) reports of use that log performances of sound recordings. (We also receive

notices of election that indicate whether the licensee has utilized any optional rates and terms.)

When SoundExchange receives payment from a licensee, that payment is logged into SoundExchange's licensee database. If this is the first payment from a licensee, a new profile is created for the licensee. If the licensee has previously paid royalties, then the payment is entered under the existing profile. If the licensee operates services in multiple rate categories, the royalty payments are allocated among the applicable rate categories based on the statements of account. Similarly, block payments by a parent corporation covering corporate subsidiaries (*e.g.* by a radio station group covering individual radio stations) may be allocated among the subsidiaries if the parent provides separate statements of account for each of the covered subsidiaries.

Loading of Reports of Use. Reports of use are associated with a service's payments and statements of account for a particular period and loaded into SoundExchange's system. The reports are supposed to provide information about the sound recording title, album, artist, marketing label, International Standard Recording Code and other information, as well as information about the number of listeners. If a report does not conform to the required format and delivery specifications, it may not load without substantial manual intervention. Instead, SoundExchange staff must review the reports, identify the kinds of corrections that need to be made, work with the service to obtain a corrected report from the service, and then attempt again to load the report into the system. In some instances, services fail to accurately report identifying data for sound recordings by, for example, identifying an artist as "Various," reporting a performer as "Beethoven" or "Mozart," or simply not providing required information. In each of these instances my staff has to research the partially identified sound recording in order to identify accurately the sound recording copyright owners and performers entitled to royalties.

Matching. SoundExchange's systems seek to match the recordings reported in licensee reports of use with information in SoundExchange's database concerning known recordings and their copyright owners and performers. Our complex log loading algorithm attempts to match identical and similar data elements and combinations of data elements from the incoming log against performance information previously received from the services. If there is a match for a particular sound recording, then the program identifies the corresponding copyright owner and performer information. However, a reported recording might not match a known recording if, for example, the service has performed a recording by an unsigned band, or a very new, old, foreign or other obscure recording that has not previously been reported to SoundExchange, or if the service has provided incomplete or incorrect identifying information.

Research. SoundExchange has built its database of sound recordings from scratch, based on information reported to it by the services. To the extent a reported recording does not sufficiently match a known recording, SoundExchange personnel will research the recording in an effort to determine whether it should be added to SoundExchange's database or whether it is in the database under different identifying information. This research requires a significant amount of staff time. Such research is often required for new releases, works reported for the first time, works from small labels, compilation albums and foreign repertoire. In the case of compilation albums, for example, finding copyright ownership information is particularly time-consuming because, although the album is issued by one label, each of the sound recordings on it could be owned by a different label.

SoundExchange conducts extensive data quality assurance work to ensure the correct association of copyright owners and performers, on the one hand, and particular performances, on the other. For example, the SoundExchange system detects what we call "performances in

conflict,” a situation in which performances of the same sound recording are reported as being on more than one label. In such cases, we conduct research to determine the correct label for the sound recording. We also review situations in which an artist has performances of different sound recordings with different labels or with “unassociated labels,” which may indicate that the label information provided to us was incorrect.

Account Assignment. SoundExchange then assigns reported sound recording performances to accounts belonging to copyright owners and performers. Performances for which a copyright owner or artist account is not identifiable (e.g., because the recording reported has not yet been matched to a recording known to SoundExchange) are assigned to a “suspense” account for later review and research. This is often the result of poor quality data provided by licensees. Performances assigned to suspense accounts are processed through the steps that follow as soon as identification is made, with the associated royalties being released in the next scheduled distribution.

Royalty Allocation. Once account assignment has occurred, a service’s royalty payments for a given distribution period are allocated to sound recordings used by that service during that period and to SoundExchange’s costs deductible under Section 114(g)(3) (sometimes referred to as SoundExchange’s “administrative fee”). Before distribution of allocated funds, SoundExchange takes several quality assurance steps to ensure accounts are payable, address and tax identification information is complete, performances in conflict are resolved and copyright owner conflicts are resolved (to the extent practicable).

Adjustment. Once allocations are completed, it is sometimes necessary to adjust particular accounts to rectify reporting and other errors that occurred in prior distributions. For example, if Copyright Owner A was incorrectly reported as the copyright owner of Song X and

received royalties for Song X, but the actual owner of that song was Copyright Owner B, then SoundExchange would need to credit Copyright Owner B in a future distribution and debit Copyright Owner A's account for the improper distribution. Adjustments typically take the form of an additional payment or a reduced payment to an existing account in the next scheduled distribution. For copyright owners and artists who are newly identified and for whom royalties have been accruing, a new account is created and royalties attributed to the suspense account are transferred to the new account. Adjustments are also made from suspense accounts to copyright owner and artist accounts based on registrations received during the period between distributions.

Distribution. This process begins with consolidating allocations across licensees' performance logs within a license category according to earning entity,¹ which are then assigned to copyright owners, artists, or certain other payees (such as a producer who an artist directs SoundExchange to pay) based on the payment instructions for each. Next, the system generates a payment file, which we transmit to our banking partner. SoundExchange generally provides each royalty-earning entity with an electronic or hard copy statement reflecting the performances – and the licenses under which the sound recordings were performed – for which the royalty payment is made. When there is a payable balance in a payee's account above the distribution threshold, a check is mailed or funds are electronically transferred.

SoundExchange's database containing payee information is derived from account information received from record labels and artists, and includes such payees as the copyright owners and artists themselves, management companies, production companies, estates and heirs. We must, however, verify address and other information and secure appropriate tax forms

¹ An "earning entity" is the person or entity who has earned the royalties from a tax standpoint and does not have to be the person who receives royalties.

directly from each artist and label. If an earning entity fails to provide SoundExchange with tax information, then we can still distribute royalties but must withhold a portion of the royalties pursuant to applicable Internal Revenue Service (“IRS”) guidelines.

SoundExchange presently conducts distributions at least four times a year for statutorily licensed uses (*i.e.*, performances pursuant to 17 U.S.C. §§ 112(e) and 114) and, at times, for non-statutorily licensed performances for which SoundExchange has collected royalties, typically from non-U.S. performing rights organizations who have money for U.S. performers or copyright owners. The threshold for distributing royalties to a payee is \$10. Distributing smaller amounts would incur significant additional transaction costs. Every payee with a balance greater than \$10 receives at least an annual distribution. Payees with balances less than \$100 receive more frequent distributions only if they have opted to be paid by electronic funds transfer rather than by check.

Payments for which SoundExchange lacks sufficient information to distribute to the appropriate copyright owner or performer are allocated to separate accounts in accordance with 37 C.F.R. § 380.8. When SoundExchange subsequently obtains the information necessary to distribute royalties to a particular copyright owner or performer, it will do so in a future distribution.

D. Challenges That SoundExchange Faces

1. The Complexities of Royalty Collection and Distribution

While SoundExchange has gained tremendous efficiencies through its custom software system, the massive scope of the undertaking and the frequency with which novel circumstances arise make the actual task of collecting and distributing royalty payments extremely complex.

Collecting royalties from hundreds of services and distributing the royalties to thousands of payees is an enormous undertaking. Working together with statutory licensees, artists, unions and record labels, we endeavor every year to streamline our processes and ensure that the maximum amount of royalties we collect are paid out to those entitled to receive them. SoundExchange has automated many of its functions (and such automation is critical to ensuring efficient distribution of royalties). About a year ago, we deployed a new royalty distribution platform that has improved SoundExchange's ability to manage royalty recipient accounts, match performances to repertoire, and manage our research work flow. This new platform automates more functions, enables us to process large volume logs more easily, and permits greater flexibility in how artist and copyright owner accounts are paid, among other things. I am very pleased with these improvements and greater automation, though SoundExchange staff still must undertake the laborious process of tracking down individuals entitled to royalties and correcting or completing misreported performance data.

The process of matching performances of specific sound recordings to individual copyright owners and performers is often difficult because many business arrangements in the recording industry are intricate and continually evolving. For a given sound recording, there may be multiple artists as well as multiple payees entitled to receive a portion of the royalties, as well as the IRS. Further, members of a band often change over the course of the band's

existence. When a band that has undergone changes in membership releases multiple versions of the same song, each release may involve payments to different people. Matching the performing band members to a particular sound recording of such a song can be complicated. For example, Fleetwood Mac has undergone multiple changes in membership since it originally formed in 1968, making the task of determining which royalties belong to which members difficult. Indeed, fourteen different individuals may claim to have been a part of the “featured artist” Fleetwood Mac at one time or another, and SoundExchange must determine which individuals are entitled to payment for which sound recording. And Sade is the name of both the individual artist Sade Adu and the band with which she has sung. When SoundExchange receives reports from licensees that list only “Sade” as the performing artist, it can be difficult to determine whether Sade Adu or Sade the band (which includes other members in addition to Sade Adu) is the proper recipient of royalties for a sound recording performance.

Band members may also share royalties on an unequal basis. In the easy case, bands or artists have a corporation that receives the royalties and the corporation assumes responsibility for dividing and distributing royalties among the band members. In some cases, however, SoundExchange itself has to locate the information regarding shares, divide the royalties, and make the payments to each band member. The general rule we have created is to distribute royalties on a pro rata basis among the members of a band when there is no indication to the contrary from band members.

Furthermore distributions can be especially complicated if an artist is deceased and there are multiple heirs (each of whom may have a different share) entitled to the royalties from the performance of a single sound recording; this is particularly true where the artist is a group and more than one group member is deceased.

2. Problems Caused by Poor Licensee Compliance

SoundExchange works diligently to pay through as high a percentage of its receipts as possible, as fast as possible. SoundExchange's royalty distributions are impeded by many licensees' submitting reports of use that are inaccurate, incomplete, improperly formatted or delinquent, or by their failure to provide reports of use altogether. SoundExchange understands that the CRJs are considering issues related to reports of use, including census reporting, in a separate proceeding, Docket No. RM 2008-7, and that proposals for regulations related to reports of use properly belong in that proceeding. To that end, SoundExchange has submitted three sets of comments in Docket No. RM 2008-7. However, I mention the problems SoundExchange faces in connection with licensees' widespread noncompliance with the reporting regulations and poor quality reports of use because it has a direct impact on SoundExchange's distribution of royalties.

SoundExchange's ability to allocate and distribute royalties depends to a large degree upon the cooperation of licensees in complying with their payment and reporting obligations on a timely basis, and among services there is widespread noncompliance with the Judges' regulations. Unfortunately, many services have not historically and still do not regularly provide reports of use or have submitted defective reports of use.

For example, in past years, RealNetworks failed to provide reports of use. This failure to comply with basic reporting requirements has caused SoundExchange to expend time and money to get RealNetworks to fulfill its obligations and prevents the prompt distribution of royalties.

In addition to missing or defective reports of use, many services fail to provide the required statement of account or other necessary documentation with their payments, or are paying at an improper rate. All of this has the effect of delaying distribution. For example, since

the Judges set the webcasting royalty rates for 2006 - 2010 in Webcasting II, Live365 has not paid SoundExchange at those new rates. Live365's recent litigation efforts suggest that it is unsatisfied by the rates set in Webcasting II. It certainly has every right to seek whatever legal remedies may be available to it, and to participate in this rate-setting proceeding to advocate in favor of different rates. But a service's unhappiness with the rates set by the Judges should not excuse the service from paying those rates.

Poor compliance by licensees impedes SoundExchange's efforts to administer the license efficiently. SoundExchange has taken a number of steps to address these problems. We have applied increased pressure on services to supply missing reports of use and to provide more compliant reports of use. We work with licensees to improve their reporting compliance. We have also assigned more SoundExchange staff to focus their attention on resolving problems with logs, and we have reallocated members of our software development team to data and distribution activities. However, all such efforts require SoundExchange's attention, time and money – all of which could have been devoted to its core mission of collecting and distributing royalties.

3. Identifying and Locating Royalty Recipients

In an effort to maintain accurate information on artists' arrangements for division of royalties as well as basic contact and tax information, SoundExchange actively engages in artist outreach. SoundExchange attends about 50 music industry conferences, meetings, festivals and events a year, and speaks to artist management firms, record labels, performing rights organizations and law firms that represent artists. SoundExchange also works with music associations to spread awareness of its services, and it advertises in a variety of media outlets.

SoundExchange personnel are available to artists (as well as to copyright owners and licensees) to provide information and answer questions, and we do so on a regular basis.

For undistributed royalties, six SoundExchange staff members' and three consultants' responsibilities include conducting research to locate artists and obtain their payee information. Even where SoundExchange is able to determine the identity of the artist and record label, that does not mean that SoundExchange knows where to locate them. Locating accurate payee information for a sound recording can be very difficult, especially if the recording is listed in a non-active, deep "catalog" or involves an artist who does not have a U.S. corporate entity designated to receive royalties on his or her behalf. Moreover, even when we locate artists or their managers, we still need them to return payee information so that we can send their royalties to them. All of these steps mean that tracking down and paying the enormous number of artists and record companies entitled to statutory royalties is a daunting task.

Through niche programming, services perform many sound recordings of smaller, less well-known labels and performers who are hard to find (and the problem is magnified if the labels are no longer in existence). SoundExchange spends a significant amount of time addressing this problem in two ways. First, SoundExchange personnel publicize the organization, its mission and its functions in order to ensure that artists and copyright owners are aware that they may have royalties owed to them. We hope that individuals who learn about us will contact us to provide us with the information we need to pay them. Second, SoundExchange performs extensive research to locate and contact individuals who may be entitled to royalties. For example, we rely on databases such as Celebrity Access and All Music Guide as well as information provided by other organizations within the music industry, both domestic and

foreign, to locate artists. SoundExchange also utilizes temporary employees, interns, and independent contractors to assist in locating individuals and entities entitled to royalty payments.

SoundExchange's ability to distribute royalties depends upon the cooperation of copyright owners and performers in providing necessary payment and tax information. SoundExchange cannot distribute allocated royalties when the artist or the rights owner or both have failed to register with SoundExchange. Inexplicably, even when SoundExchange contacts artists about unpayable royalties, some of them fail to submit the proper registration information to enable payment. In addition, many artists change address frequently, and it is not uncommon that an artist SoundExchange has previously paid will move but fail to inform SoundExchange of his or her new address. SoundExchange is then unable to distribute royalties to that artist until he or she can be located again. If artist group members cannot agree to the splits among them for their repertoire or if there are multiple claims against the same repertoire (as with two foreign collecting societies claiming the same sound recording), those payments will be placed on hold, pending resolution of the dispute.

SoundExchange is working to address these challenges in several ways in addition to the outreach measures discussed above. For example, instead of issuing checks, we offer royalty recipients the option of receiving their royalties through automated check clearinghouses that essentially offer direct deposit into bank accounts. Even when artists tour frequently and change their addresses, their bank accounts generally remain the same. Under this system, when an artist moves or is touring, he or she will continue to receive payments directly into his or her bank account. In addition, we continue to pursue initiatives with foreign collectives to locate artists. SoundExchange has developed relationships and negotiated agreements with sister royalty societies around the world, including SOMEXFON in Mexico, PPL in the United

Kingdom, ABRAMUS and UBC in Brazil, AIE in Spain, RAAP in Ireland, and SENA in the Netherlands. Under these agreements, SoundExchange remits royalty payments due to copyright owners or performers represented by those societies. In some agreements, SoundExchange receives royalty payments for performances of U.S. sound recordings that these analogous societies have collected.

We also work with other organizations with connections to the artist community to compare our unmatched lists to data they maintain about artists. When those organizations have contact information for artists for whom we lack information, they contact the artists and encourage them to register with SoundExchange and collect their royalties. Furthermore, we have launched on-line registration, so that artists and copyright owners can register with SoundExchange without having to use conventional mail. Finally, we continue to appreciate the efforts of our record label members who encourage their artists to collect their SoundExchange royalties.

IV. SoundExchange Should Be Designated the Sole Collective to Collect and Distribute Webcasting Royalties.

In Webcasting II, the Judges found “that selection of a single Collective represents the most economically and administratively efficient system for collecting royalties under the blanket license framework created by the statutory licenses.” Faced with testimony and evidence submitted by SoundExchange and RLI, the Judges concluded that “SoundExchange is the superior organization to serve as the Collective for the 2006-2010 royalty period.” 72 Fed. Reg. at 24105 (May 1, 2007).

I agree with the CRJs’ conclusions, and request that the Judges again designate SoundExchange as the sole Collective to collect and distribute royalties for the 2011-2015 statutory period. SoundExchange now has considerable experience and expertise in

administering the statutory licenses. Whereas at the time I submitted my written direct testimony in Webcasting II, SoundExchange had processed over 650 million sound recording performances, 72 Fed. Reg. at 24104, SoundExchange has now processed billions of sound recording performances. SoundExchange has continued to increase the size of its membership and the number of record label and artist accounts it maintains. Whereas at the time the Webcasting II direct testimony was submitted, SoundExchange had approximately 3,000 record label members and 12,000 artist members, 72 Fed. Reg. at 24104, today SoundExchange has approximately 9,700 record label members and 29,000 artist members. And while SoundExchange had over 700,000 sound recordings in its database when I submitted my written direct testimony in Webcasting II, today that number has grown to nearly 2 million.

I am aware that RLI has filed a petition to participate in Webcasting III. I oppose any effort by RLI to be designated as the sole Collective or as an alternative collective to collect and distribute statutory webcasting royalties. In selecting SoundExchange over RLI as the sole Collective in the Webcasting II proceeding, the Judges expressed “serious reservations about the bona fides of Royalty Logic to act as the Collective under the statutory licenses.” Webcasting II, 72 Fed. Reg. at 24105. The Judges noted that RLI is a for-profit organization that wants to enter the royalty collection and distribution business to make money; that the testimony of Mr. Gertz raised concerns “as to whether Royalty Logic will act in the best interest of all copyright owners and performers covered by the statutory licenses”; that RLI’s relationship with copyright users and services “elevated” these concerns; and that RLI’s arguments about the potential effects of competition between collectives were not relevant. Webcasting II, Fed. Reg. at 24105.

In my testimony in Docket No. 2005-1 CRB DTRA, I discussed the problems associated with a system that includes more than one collection and distribution agent. Those problems

remain true today. SoundExchange's system presently contains entries for tens of thousands of copyright owners and performers and nearly 2 million sound recordings. For the system to recognize multiple agents, SoundExchange would have to expend significant resources, both human and monetary, to create the accounting platform necessary to track numerous distributing agent relationships, keep accounts current when entitled parties change affiliation with multiple agents, and still ensure timely distributions. Adding multiple agents would not only create administrative costs and burdens, but would also result in substantial delay in distributing royalties owed. The resulting complexity and administrative burden would serve no one and would lead only to a large number of disputes between collectives – disputes that might end up back before the Judges.

In my view, a multi-agent system is anathema to the concept of an efficient statutory licensing system. Although proponents of a multi-collective system often point to ASCAP, BMI, and SESAC – the musical works performing rights organizations – it is important to understand that administering a statutory license is fundamentally different from what those organizations do. Those organizations all engage in direct, voluntary licensing. They represent their members (and only their members) and are able to compete for members by negotiating different rates and terms for collection and distribution of royalties. They only collect and distribute monies for their own members, and have no responsibility to anyone other than their members.

Under the Copyright Act, SoundExchange is in the position of administering a statutory license whose rates and terms are set by the Judges. There cannot be “competition” between collectives on rates and terms; the only “competition” would be created by one collective trying to free-ride off the efforts of another, as RLI has done in the past and may want to do in the future. Moreover, because many copyright owners and performers will be members of no

organization, there must be an entity that has the responsibility of researching and identifying their recordings, locating them and ensuring that they too receive the royalties to which they are entitled. SoundExchange (or its predecessor) has undertaken that responsibility since royalties began being paid under Section 112(e) and Section 114 of the Copyright Act.

Where a statutory license has specified rates and terms, it only makes sense for a single entity to provide administration. As I discussed in my prior testimony, if multiple collectives were to administer the same license, the collection and distribution process would grind to a halt.

Moreover, designating a second Collective would create greater overall costs because copyright owners and performers would have to pay for duplicative systems for license administration. Similarly, designating a new Collective to replace SoundExchange would be inefficient. SoundExchange has invested substantial time, effort and money into developing its collection and distribution systems, and has developed great expertise in administering the statutory license. The benefits to copyright owners and artists of that experience and expertise would be lost if a different entity were designated as the Collective. Copyright owners and artists would also be harmed because they would subsidize the costs of transitioning to a new Collective.

V. The Minimum Fee

SoundExchange proposes setting the statutorily-required minimum fee at \$500 per channel or station, subject to a \$50,000 annual cap for commercial webcasters. This proposal is supported by agreements that SoundExchange is submitting as evidence, and would ensure that every licensee makes some contribution to the costs of administering the statutory license.

A. Agreements

SoundExchange's agreements under the Webcaster Settlement Act establish that services are willing to pay the minimum fee that SoundExchange is seeking in this proceeding.

SoundExchange has submitted two settlements to the CRJs for publication and adoption – a Broadcasters agreement with the National Association of Broadcasters (“NAB”) and a Noncommercial Educational Webcasters agreement with College Broadcasters, Inc. (“CBI”).

The parties entered into the Broadcasters agreement pursuant to the Webcaster Settlement Act of 2008, and the Noncommercial Educational Webcasters agreement pursuant to the Webcaster Settlement Act of 2009. In addition, SoundExchange has entered into a Commercial Webcaster settlement with Sirius XM pursuant to the Webcaster Settlement Act of 2009. The agreements provided eligible services an opportunity to opt into the agreements and accept the rates and terms established by them.

The NAB agreement covers the time period 2006 through 2015, and includes an annual minimum fee of \$500 per station or channel, subject to a \$50,000 cap. According to SoundExchange's records, 404 entities have opted into the NAB agreement on behalf of several thousand individual stations.

The Commercial Webcaster Agreement covers the time period 2009 through 2015, and likewise includes an annual minimum fee of \$500 per station or channel, subject to a \$50,000 cap. Sirius XM has opted into the agreement for its webcasting service.

The CBI agreement covers the time period 2011 through 2015 (with special reporting provisions for 2009-2010), and includes an annual minimum fee of \$500 per station or channel. The opt-ins for the CBI agreement are not due until January 2010. The minimum fee in the CBI agreement has no cap but, in our experience, the huge majority of noncommercial services never

pay more than \$500, and no individual noncommercial licensee that pays SoundExchange reports more than ten stations on its statements of account, let alone the 100 that would reach the cap in the commercial webcaster context. In addition, for noncommercial services, \$500 covers the first 159,140 ATH per channel or station as well, meaning that a cap would be inappropriate. For example, if a noncommercial webcaster offered 150 channels, but was subject to a cap of \$50,000 at a minimum fee rate of \$500 per channel, that noncommercial webcaster should not get 159,140 aggregate tuning hours of usage on 50 channels for free.

These agreements show that both commercial and noncommercial stations are willing and able to pay a \$500 minimum fee.

B. Contribution Toward Administrative Costs

One rationale for the minimum fee that has been raised in past proceedings is that it should cover SoundExchange's administrative expenses even in the absence of royalties. 72 Fed. Reg. at 24096 (May 1, 2007). I agree that the minimum fee should ensure that every licensee makes an appropriate contribution to the costs of administering the statutory license, as well as a reasonable payment for usage of sound recordings. After all, if the minimum fee covered only administrative expenses, then copyright owners and performers collectively would receive no payment for the use of their sound recordings by services paying only the minimum fee. Those payments would in effect be completely consumed by costs of administration.

That said, SoundExchange has never sought to collect all of its costs from minimum fee payments. Payments from services that pay larger amounts of royalties in effect subsidize the costs associated with processing payments and information from smaller services that typically pay only the minimum fee.

SoundExchange's per service or per station or channel administrative costs are difficult to quantify. The expenses that SoundExchange incurs in relation to particular services vary widely depending on the quality of data that a service provides to SoundExchange and on the additional work that SoundExchange may need to do when it receives poor quality data. In addition, some large station groups submit separate statements of account and reports of use for each of their individual stations. This means that we need to process each such station individually, rather than as a group, which necessarily adds time to our efforts. Our costs also vary depending on the breadth and obscurity of a service's repertoire, with services that play a great deal of repertoire that is relatively unique imposing greater research costs. In addition, many of our costs are effectively shared across services – including things like research of repertoire used by multiple services, costs of artist outreach and distributing royalties once individual services' allocations are loaded, information technology and corporate overhead. SoundExchange does not track its administrative costs on a licensee-by-licensee, station-by-station or channel-by-channel basis and, as a result, there is no precise way to determine exactly what we must spend on such a basis.

As a check on whether the minimum fees agreed upon in SoundExchange's Webcaster Settlement Act agreements and proposed in this proceeding are reasonable in light of our administrative costs, SoundExchange nonetheless estimated our administrative costs per service. Based on current (and as of this point unaudited) records, SoundExchange's expenses for 2008 were approximately \$8.4 million. This amount includes SoundExchange staff, facilities, amortized and depreciated equipment, operating expenses, and other costs. This amount excludes the amortization of costs of rate-setting proceedings. In 2008, SoundExchange had 1,440 licensees (at the statement of account level) of all license types. When SoundExchange's

operating costs are divided by the number of licensees, the result is a per licensee cost of approximately \$5,833.

While the overwhelming majority of these licensees (about 1,371) operated only one station or channel, some operated multiple stations or channels. The number of individual channels or stations on a licensee's service is often an indicator of greater complexity required to handle such payments and reporting. However, it is unclear how many "stations" there actually are in the case of a handful of internet-only services that allow users to create channels, and handling payments and reporting by those services is probably not hundreds or thousands of times more expensive or complex than handling payments and reporting by a service with only one channel. That is why we have been willing to agree to a cap on the minimum fee corresponding to 100 channels or stations per licensee, and propose such a cap for commercial webcasters in this proceeding.

As a further check on our proposed per channel or per station minimum fee, we tried to determine the average number of channels or stations per webcaster licensee. Calculating the average number of channels or stations per webcaster is necessarily an inexact exercise. Services do not always report the total number of channels or stations, and as noted above, for services that allow users to create channels, it is unclear how many "stations" there actually are. In estimating the average number of stations or channels per webcaster, we used actual numbers where that information is reported to us. Where that information is not reported to us, but where a service provides information about the number of its stations or channels on a publicly available website, we used that information. For the small number of services for which we lack information about their total number of stations or channels, but for which we are generally aware that they have a large number of stations or channels, we assumed 100 stations or

channels. The assumption of 100 stations or channels is consistent with SoundExchange's proposal of a \$50,000 cap on minimum fees for commercial services with 100 or more stations or channels where the minimum fee is \$500.

Based on the foregoing information, we determined that there are an average of about seven channels or stations per webcaster licensee at the statement of account level. As a matter of arithmetic, SoundExchange's average per channel or station cost for webcasters in 2008 was approximately \$833 (\$5,833 divided by 7). One could do this analysis differently. For example, if one capped at 100 the number of channels on services known to have a much larger number of channels, one would get a lower average number of channels or stations per webcaster licensee at the statement of account level and a correspondingly higher average per channel or station cost.

The exact cost imposed by any particular licensee varies widely. Every single statement of account and every single report of use must go through the entire process described above – the payments and statements of account must be reviewed, verified, and recorded; and the reports of use must likewise be reviewed, tested, logged, and loaded into the distribution engine. Any problems with paperwork or logs can introduce problems and cause delay.

Nonetheless, the estimates described above demonstrate that SoundExchange's proposed minimum fee of \$500 per station or channel is below our estimated per station or channel costs. As indicated above, SoundExchange has never sought to collect all of its costs from minimum fee payments. Payments from services that pay larger amounts of royalties in effect subsidize the costs associated with processing payments and information from smaller services that typically pay only the minimum fee. However, because \$500 per station or channel does not recover all of our administrative costs, particularly if the minimum fee is understood to include

some payment for usage of sound recordings, that level of payment represents a reasonable and justified contribution to the costs of administering the statutory license.

VI. License Terms

SoundExchange generally proposes continuing the same terms in this proceeding as the Judges adopted in the Webcasting II proceeding, Docket No. 2005-1, subject to the revisions described below with regard to (i) server log retention, (ii) late fees for reports of use, (iii) identification of licensees, and (iv) certain technical and conforming changes.

Although the Judges did not rule in SoundExchange's favor on all of the terms issues raised in the Webcasting II proceeding, the Judges clearly recognized many of SoundExchange's concerns, and the terms adopted in that proceeding represented an important step forward. In the SDARS proceeding, Docket No. 2006-1, the Judges adopted terms that were largely similar to the terms adopted in the Webcasting II proceeding, except to the extent dictated by differences in the rate structure and for certain technical changes. I believe there is value in having consistency of terms across licenses, and in allowing time to fully assess the effectiveness of those terms based on experience working under those terms. Consistency among the terms regulations for the various types of services and over time aids SoundExchange's administration of the licenses and makes licensees' compliance with the terms more efficient.

For all of these reasons, SoundExchange proposes that the Judges adopt the same terms regulations as it adopted in Docket No. 2005-1, as codified at 37 C.F.R. Part 380, except as discussed below.

A. Server Log Retention

SoundExchange proposes that the statutory license terms expressly confirm that the records a licensee is required to retain pursuant to 37 C.F.R. § 380.4(h) and that are subject to

audit under 37 C.F.R. § 380.6 include server logs sufficient to substantiate rate calculation and reporting. Licensees often do not retain the actual server logs showing which transmissions were made when. This data is critical for verifying that licensees have made the proper payments.

The current royalty rate structure is based on the actual performances transmitted, and SoundExchange proposes continuing that rate structure in the next rate period. Every webcaster's transmissions are made by computer servers that typically generate original records of what recordings they transmitted to how many users and when. Those logs should become the basis for a licensee's statements of account and reports of use. However, if SoundExchange cannot compare those logs to the statements of account, reports of use and other records maintained by the licensee that purportedly were derived from the server logs, we are missing the first – and perhaps most important – link in the chain of records that establish actual usage.

While I believe the current regulations already require licensees to maintain their server logs for at least a three year period, because they are “records of a Licensee . . . relating to payments of . . . royalties.” 37 C.F.R. § 380.4(h), some licensees apparently take a different view and do not retain their server logs. Accordingly, SoundExchange proposes that the Judges make this requirement more explicit.

B. Late Fees for Reports of Use

SoundExchange proposes that reports of use be added to the list in 37 C.F.R. § 380.4(e) of items that, if provided late, would trigger liability for late fees. SoundExchange made a similar proposal in the pending notice and recordkeeping proceeding, Docket No. RM 2008-7. The implementation of that concept could be included in either the notice and recordkeeping regulations or the license terms. Implementing the concept in the license terms would be appropriate because late fees are otherwise provided for in the license terms, and timely

provision of reports of use is essential to the distribution of statutory royalties as contemplated by the license terms. Indeed, reports of use are at least as important to timely distribution as statements of account, which are subject to late fees. SoundExchange is raising the issue here in case the Judges would prefer to consider the issue in the context of this proceeding, rather than in the recordkeeping proceeding.

As SoundExchange explained in Docket No. RM 2008-7, widespread noncompliance with reporting requirements demonstrates that it is important to provide greater incentives to compliance than in the past. We receive no reports of use from many webcasters, and the reports we received were often late or grossly inadequate. This is a significant impediment to our timely payment of copyright owners and performers. Other than the threat of litigation, there is no commercial incentive for a service to comply with the regulations governing reports of use. The possibility of late fees would provide an additional, immediate incentive to comply with the applicable reporting requirements and would greatly facilitate operation of the statutory licenses.

C. Identification of Licensees

SoundExchange proposes that statements of account correspond to reports of use by identifying the licensee in exactly the way it is identified on the corresponding notice of use and report of use, and by covering the same scope of activity (e.g., the same channels or stations). In addition, the regulations should be clarified to explain that the “Licensee” is *the entity* identified on the notice of use, statement of account, and report of use, and that each Licensee must submit its own notice of use, statement of account, and report of use. Under this proposal, a station group could choose to submit separate statements of account for each of its stations, but if it did, it would also have to have filed a corresponding notice of use for each station and would have to submit separate reports of use for each station. Likewise, a station group could choose instead to

file a single statement of account covering all of its stations, but in that instance, it would need to supply a single notice of use and a single report of use covering all of its stations. We would prefer that station groups consolidate their reporting to the extent possible.

Because SoundExchange receives reports from hundreds of webcasting payors covering thousands of channels and stations, we devote considerable effort to reconciling changes and variations in licensee names and matching statements of account to reports of use covering different combinations of channels and stations. Those aspects of our work would be greatly simplified at little or no evident cost to licensees if licensees were required to provide notices of use, statements of account and reports of use on a consistent basis, and to use consistent names to refer to themselves in such documents.

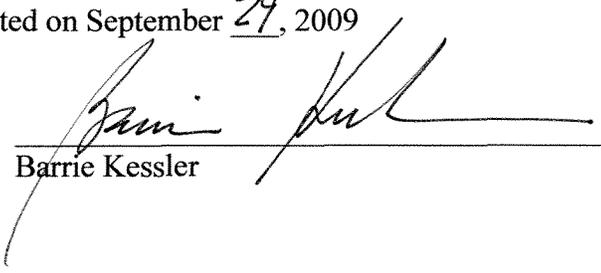
In addition, we would like a regulation requiring licensees to use an account number, that is assigned to them by SoundExchange, on their statements of account and reports of use. This unique identifier would make it easier for SoundExchange to identify each licensee in our system, and to distinguish between services with similar names. This proposal would not burden licensees, and indeed might simplify their reporting and accounting efforts, as well.

D. Technical and Conforming Changes

Finally, SoundExchange is proposing a few technical and conforming changes to the regulations, including changes that would be helpful to make for the sake of clarity or consistency across licenses. These proposed changes are reflected in the redlined proposed regulations that SoundExchange is submitting as an attachment to its rate proposal.

I declare under penalty of perjury that the foregoing testimony is true and correct.

Executed on September 29, 2009



Barrie Kessler