Before the
UNITED STATES COPYRIGHT OFFICE
Library of Congress

Notice of Proposed Rulemaking	)	
	)	**37 C.F.R. Part 201**
	)	**Docket No. 2012-5**
Verification of Statements of Account	)	
Submitted by Cable Operators and	)	
Satellite Carriers	)	
	)	

Comments of AT&T Inc.

AT&T Inc., on behalf of its operating company affiliates (collectively "AT&T"), offers these Comments on the Copyright Office's Notice of Proposed Rulemaking (the "NPRM") proposing a new regulation to implement the audit provisions of the Satellite Television Extension and Localism Act of 2010 ("STELA"). 77 Fed. Reg. 35,643 (June 14, 2012) (the "Proposed Rule").

AT&T is one of the nation's largest and fastest-growing providers of television services operating under the section 111 statutory license. The AT&T U-verse TV service is offered over 62 statutory license reporting systems to more than 4 million subscribers. In the second half of 2011 AT&T paid more than $9 million in section 111 royalty fees. AT&T thus has a substantial interest in ensuring that the Copyright Office's implementation of the audit provisions of STELA accomplishes its goals in a manner that (i) is procedurally fair and (ii) does not impose unreasonable burdens on television system operators that are subject to audit.

AT&T appreciates the efforts of the Copyright Office in the Proposed Rule to recognize the interest of the licensees. AT&T is concerned, however, that despite these efforts, the Proposed Rule would subject system operators to unreasonable burdens and could invite abuse by those with an audit right. Audits can be and often are highly disruptive and burdensome. The audit subject must devote internal staff and resources to review and produce the requested information, to respond to questions and potential additional requests for information, and to review and respond to initial findings. At AT&T, for example, the staff that would respond to an audit is the same staff that is responsible for preparing 62 statements of account twice a year. That work essentially occupies the full time of the staff from two weeks before the close of each semi-annual period through the due date for the report, two months after the close of the period.

The Company understands that many aspects of the Proposed Rule were offered as a "starting point for further discussion" (see, e.g., 77 Fed. Reg. at 35, 647), and offers these comments in that spirit.

I. Audits Should Be Limited to One Audit Per Year of a Reasonable Number of a System Operator's Systems, and Any Year Should Be Subject to Audit Only Once.

AT&T agrees with the Copyright Office that the audit process should be initiated by the publication of a Federal Register notice requiring all copyright owners that are interested in participating in an audit of a particular licensee television system to join in a single audit using a single, mutually agreed, independent auditor. In this regard, the Proposed Rule comports with the statutory requirement for designation of "a qualified independent auditor" to conduct a verification "on behalf of all copyright owners," and with the Office's auditing precedent for Audio Home Recording Act and other audits. It would be unreasonably wasteful of all parties' resources to permit multiple audits of the same statements of account by different copyright owners.

AT&T is concerned, however, that the Proposed Rule's provisions governing the number and frequency of audits threaten to impose substantially greater burden than necessary. More specifically, AT&T submits that an operator of multiple systems ("MSOs") should be subject to a single audit: (i) in any year, and (ii) with respect to the statements of account for any given year. Thus, once an audit is initiated, all copyright owners should be required to agree on the particular systems to be audited and the years that are to be the subject of the audit. No further audits should be permitted during that year. Moreover, once statements of account for any year are audited, other statements of account for that year should not be subject to further audit, subject to the expansion rules discussed in Part V, below.

The NPRM offers no reason for its proposal to burden MSOs with up to three audits in any year. As discussed above, any audit causes disruption and burden. Two audits are likely to be significantly more disruptive and burdensome than one; three audits are likely to be significantly more disruptive and burdensome than two. Multiple audits are particularly burdensome where the system operator's accounting and reporting operations are centralized in a single staff, as they are at AT&T.

Notably, the regulations cited by the Office as precedent for the Proposed Rule all provide for a single audit during any calendar year, and all but one (the 1998 preexisting services rule) prohibit multiple audits of the same statement of account (or calendar year). *See, e.g.*, 37 C.F.R. § 201.30(c)(5) (anti-duplication rules, stating "A filer shall be subject to no more than one verification procedure per calendar year. An Annual Statement of Account shall be subject to a verification procedure only once."); *id.* §§ 260.5(b); *id.* §§ 261.6(b), 262.2(b) ("A Designated Agent may conduct a single audit of a Licensee, upon reasonable notice and during reasonable business hours, during any given calendar year, for any or all of the prior three (3) calendar years, and no calendar year shall be subject to audit more than once.").

Moreover, the Proposed Rule fails to impose any limit on the number of systems or statements of account that may be audited for any operator of multiple systems. The Proposed Rule's nominal limit of 50% of an MSO's systems per audit is illusory; copyright owners need only agree to conduct two audits, each covering 50% of the systems, thereby auditing 100% of the MSO's systems. That is not a limitation.

Even if the 50% limit had meaning (*e.g.*, if the rule imposed a limit capping at 50% the number of an MSO's systems that are subject to any audit for a given year), it would not be a reasonable limit. For example, under such a rule, AT&T would be subject to having 31 systems audited in a year, a scope that would cause substantial burden and disruption.

The accuracy of an MSO's statements of account can be ascertained in most cases (and issues and concerns can be identified) with a substantially smaller sample than 50% of the MSO's of systems. For example, in the second half of 2011, the 15 largest U-verse licensed systems accounted for more than 68% of the section 111 royalty fees paid for the service. Reasonable assurance of the correctness of AT&T's reports and reporting procedures could be accomplished with a substantially smaller sample than those 15 systems. It would be unnecessary and unreasonably burdensome to require a larger audit.

Copyright owner interests can be satisfied with significantly less burden and disruption by providing that there shall be no more than one audit in any year and no more than one audit for any year, and by limiting that audit to a reasonable sample of systems that is substantially smaller than 50% of an MSO's systems. To the extent the Office is concerned that the initial copyright owner's notice of intent to audit may not cover all of the systems that other copyright owners may want to have audited, the interested copyright owners should agree on the systems to be audited as part of their coordination process, subject to the limits described above. Subject to the limitations discussed in this Part and the three-year time limit on audits, copyright owners should retain the flexibility to identify the systems to be audited and the years for which those systems are to be audited.

II. The Copyright Office Should Strengthen the Proposed Rule's Provisions Governing Independence and Qualifications of the Auditor.

The qualification and independence of the selected auditor is an important safeguard for audit subjects and for the public. As a general rule, AT&T has no objection to relying principally on the auditor being a certified public accounting, and on the AICPA ethics and audit rules, with the understanding that the auditor is in good standing and is not the subject of any disciplinary inquiry or proceeding. That understanding should be expressly set forth in section 201.16(e)(2)(i).

The AICPA rules governing independence of the auditor are generally comprehensive, but the Proposed Rule's incorporation of the term "independent" does not appear to incorporate the AICPA's prohibition of contingent fees. The Ethics Rule

governing independence (ET 102) is clearly incorporated by the Proposed Rule. The Ethics Rule prohibiting contingent fees, however, is contained in a different Ethics Rule (ET 302) that does not appear to be expressly tied to "how [the term 'independent'] is used" in the Code of Professional Conduct. Thus, it is not clear that it is incorporated by the Proposed Rule.

A prohibition on fees that are in any way dependent about the outcome of an audit is an essential step in protecting against the possibility that the auditor will be influenced in the audit process by potential monetary gain. To ensure that there is no ambiguity, and that the prohibition on contingent fees is applicable to the auditor, AICPA Ethics Rule ET 302 should explicitly be incorporated into section 201.16(e)(2)(iii) in the same way that the Proposed Rule expressly prohibits the auditor from being an officer, employee or agent of the copyright owner.

Audit subjects likely will not have all of the relevant information pertaining to the qualifications or independence of the auditor. Accordingly, auditors should be required, prior to commencing a STELA audit, to file a certification with the Copyright Office attesting to the fact that the auditor meets the standards of section 201.16(e) (as amended pursuant to these comments). The certification should recite that it is being made for the third party benefit of the audit subject.

Finally, any controversy concerning the independence and qualifications of the auditor should be resolved before an audit commences. Licensees should not be required to disclose confidential information or submit to the disruption or burden of an audit by an auditor whose qualifications or independence has been challenged. Thus, the last clause of section 201.16(e)(1) should be amended to strike "while the audit is being performed," and to insert "before the audit commences."

III. The Scope of the Audit Should Be Limited to Accounting Issues that Are Not Determinable on the Face of the Statement of Account.

The Proposed Rule establishes a scope for the audit that is broader than reasonably necessary to protect copyright owner interests. According to the NPRM, the only limitation of the audit is that it should be performed in accordance with GAAS. 201.16(f). That language is important, but it offers no limitation on what information the auditor may request or on the issues the auditor is permitted to address. Both should be appropriately limited, in order to ensure that the process does not become an unnecessarily disruptive or burdensome fishing expedition.

STELA itself limits the scope of the audit to "confirm[ing] the correctness of the calculations and royalty payments reported" in the statement of account. The regulations should expressly include this limitation.

Moreover, many potential disputes over the amount of section 111 royalty payments do not require an audit; the information is available on the face of the statement of account. For example, issues related to the proper classification of stations (*e.g.*, as

distant, local, permitted, or non-permitted) are already examined by the Copyright Office and may be challenged by copyright owners from information available on the face of the statement. There is no reason to impose further costs on systems by opening such issues to examination by an auditor. Nor, as discussed in Part IV, below, is there any justification for allowing claims based on such issues to trigger cost-shifting or the expansion of an audit examination. The regulations should provide that the audit may not extend to issues that may be determined on the face of the statement of account.

The AHRA regulations on which the Office relies as precedent expressly limit the information to be examined and the scope of the audit. Those regulations provide that "[t]he verifying auditor shall limit his or her examination to verifying the information required in the Annual Statement of Account." 37 C.F.R. § 201.30(e). The AHRA rules go further, and provide that "to the extent possible, the verifying auditor shall inspect the information contained in the primary auditor's report and the primary auditor's working papers." *Id.* Notably, these scope limitations apply on top of a verification structure that is, by its nature, more protective to the audit subject than the Proposed Rule – the primary audit is conducted by the filer's own auditor.

The regulations should similarly limit STELA audits. System operators should be required to provide only such information as is reasonably necessary to permit the auditor to confirm the correctness of the calculations and royalty payments (excluding issues that may be determined on the face of the statement of account).

IV. The Copyright Office May Not and Should Not Adopt a Regulation that Requires a System Operator To Pay Audit Costs.

AT&T objects to the cost-shifting provision of the Proposed Rule. Nothing in STELA authorizes the Copyright Office to impose the costs of the audit on the party being audited, and the Office lacks authority to require such a transfer of funds. The authority granted by STELA is limited to issuing regulations "to provide for the confidential verification by copyright owners" using an auditor acting "on behalf of all copyright owners." The statute is explicit in defining the specific authority it grants:

- Establishing procedures for the designation of a qualified independent auditor;
- Establishing procedures for safeguarding confidential information;
- Requiring a consultation procedure to allow the audit subject to review the auditor's conclusions;
- Establishing a mechanism for the cable system to remedy any errors and cure any underpayments;
- Providing an opportunity to remedy any disputed facts or conclusions;
- Limiting the frequency and number of audits; and

- Establishing a three-year limitation on requests for audits.

None of these grants includes authority to order a licensee to pay the auditor's fees. Rather, by providing that the auditor is working on behalf of copyright owners, STELA implies that the auditor should be paid by those copyright owners.

Nor can the Office point to any other provision of law authorizing it to impose such fee shifting. Where Congress has granted the Office the authority to impose fees, it has been explicit. *See* 17 U.S.C. § 708. Congress has not done so here.[1]

Moreover, cost shifting in this context is inconsistent with the purpose of the STELA audit process. STELA audits are intended to allow copyright owners to review statements of account for accuracy and to provide an opportunity (i) for copyright owners to identify potential deficiencies, and (ii) for licensees to make additional payments to make up those deficiencies (or to avoid further dispute). The audit provides its own benefit – if the auditor finds a deficiency, copyright owners either (i) receive additional payments from the system operator, or (ii) obtain information to use in challenging the licensee's filings. These benefits are explicit in the statute, which requires the Register's regulations to provide an opportunity for cable systems to remedy any errors, remedy disputed facts, and make additional payments. The detail with which the Act defines these audit results and the absence of any provision relating to cost shifting, further confirms that Congress did not intend for the Register to authorize cost shifting.

Conversely, the audit process already imposes its own costs on the audited licensees, who must expend substantial resources to participate in the audit, without any corresponding benefit. There is no justification for a provision that threatens to impose additional costs on audited licensees. The audit provisions in STELA are not intended to be punitive.

Further, STELA contemplates that audits will help reduce controversy and will lead to the resolution of disputes quickly and inexpensively, by providing system operators with an opportunity to "remedy errors. . . and cure any underpayment." Cost shifting is inconsistent with this goal, as it will create a disincentive for system operators to make such payments to the extent such a payment may be viewed as a concession (or even as evidence) that there was, in fact, an underpayment. By increasing the potential costs to the system operator, cost shifting threatens to increase, not reduce, controversy.

Similarly, a cost-shifting provision would create improper incentives for copyright owners and the auditors they retain to seek out and raise as many issues as possible, whatever their merit. This would also have the effect of increasing both controversy and the costs of the audit process. Even assuming (as discussed in Part II) that the auditor's compensation for an audit will not depend on the outcome of that audit, the auditor's prospects for being retained by copyright owners to conduct future

[1] AT&T recognizes that the Copyright Office has adopted regulations providing for audit cost shifting under other legislation (e.g., 17 U.S.C. §§ 114, 1003(c)(2), 114). The fact that *ultra vires* action under other statutes has not yet faced judicial review does not authorize such action under STELA.

employment will likely be influenced by past audit results. Cost shifting would only exacerbate this pressure on auditors.

Nor is it clear that cost shifting could be implemented reasonably in this context. There is no process for resolving disputes or for determining how much a system operator has underpaid. It is not uncommon for audit results to turn on a question of legal or regulatory interpretation, or the application of an accounting rule, on which reasonable minds can differ. Copyright owners have a remedy if they believe a system operator has reported improperly. The audit provides further ammunition to make such a claim. However, it would be wholly improper for the copyright owners' auditor to be prosecutor, judge and jury where a dispute arises.

Indeed, a regulation that purported to impose costs on the system operator based on the judgment of a private party would implicate due process and delegation concerns, which preclude the delegation of governmental powers to private parties with an interest in the business or matter to which the delegation pertains. *See Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 529 (1935). Such action represents "legislative delegation in its most obnoxious form," since it effectively grants an interested private party the authority to regulate "private persons whose interests may be and often are adverse." *Carter*, 298 U.S. at 311. A regulation "which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property," is "clearly arbitrary, and . . . a denial of rights safeguarded by the due process clause of the Fifth Amendment." *Id.*

The Proposed Rule's procedure for reversing shifted costs upon a "final judgment," offers little, if any, meaningful protection for audited licensees. The Act does not create a cause of action in favor of a licensee that has been the subject of an audit. Thus, absent the existence of some creative state-law theory, a licensee that wished to challenge an audit finding likely could do so only if the copyright owners chose to file an action, which is entirely out of its control. That is not due process.

If the Register decides to adopt a cost-shifting provision, which she should not, there are several principles that should guide such a provision. First, the 5% threshold is too low and offers an invitation for controversy. A more reasonable provision is the provision set forth in 37 C.F.R. § 261.6(g), one of the provisions cited by the Register as precedent. That provision provides that costs shall not be imposed on the audit subject unless "it is finally determined" that there is an underpayment of 10% or more, and then, the costs imposed must be "reasonable," and shall not exceed the amount of the underpayment (unless the underpayment exceeds 20% *and* $5,000). For example, a licensee should not be required to pay the costs of a $15,000 audit to identify a $5,000 deficiency. Given the likely cost of STELA audits, the minimum threshold should be increased to $10,000. Second, the there should be no cost shifting unless the copyright owners sustain the burden of establishing the requisite under-payment in a judicial proceeding, i.e., an underpayment is "finally determined." Under no circumstances

should cost shifting be based on the auditor's report. *Compare* 37 C.F.R. § 201.30(d) (providing for cost shifting after a "judicial determination").

Third, underpayments attributable to issues that are identifiable on the face of the statement of account (such as classification of stations or other issues reviewed by the Copyright Office) should not be considered in assessing the amount of the underpayment. Cost shifting should not hinge on issues for which an audit was not necessary. Any other rule would create a perverse incentive to base the decision to audit a statement of account on whether there was already an issue identified that did not require an audit. Similarly, underpayments attributable to reasonable disagreements about issues of law, construction of regulations, or accounting procedures should not give rise to cost shifting. The auditor is not a legal or regulatory expert, and a system operator should not be penalized for taking a position on an issue about which reasonable minds may differ.

Fourth, as discussed above, an audit imposes substantial costs on the audit subject. To be fair, any audit fee shifting provision should be bilateral so that it creates a disincentive to abuse the audit rights created under STELA. In the context where a 10% underpayment triggers a payment of audit costs, the bilateral rule should be that an overpayment should entitle the licensee to reimbursement of its reasonable audit costs, including in-house costs, from the copyright owners requesting the audit.

Fifth, in the case of an audit of multiple systems, costs should not be shifted unless the audit discovers the requisite percentage underpayment across the universe of audited systems. An MSO that paid properly on 5 systems should not be required to assume the cost of the audit of a 6th system that was underpaid by 11%.

Sixth, if the rules permit the scope of an audit to be expanded based on a finding of an under payment, cost shifting for the expansion should stand on its own. In other words, underpayments discovered in the initial audit should not provide copyright owners with a free ride to expand the audit at the expense of the licensee. Any other rule would create an incentive for copyright owners to expand any audit (at the subject's expense) where the findings of the initial audit supported cost shifting or could contribute to cost shifting for the expansion.

V. The Right To Expand the Number of Systems that Are Audited Should Be More Significantly Limited.

Due to the costs and burdens imposed by the audit process, the copyright owners' right to expand the number of systems that may be audited in and for any year should be limited more meaningfully than under the Proposed Rule. Expansion of the audit beyond the original cap on audited systems should require good cause. For example, given the costs of participating in an audit, there should be an absolute minimum requirement (in addition to the percentage requirement) for expanding an audit. Given the costs, an underpayment of less than $10,000 should not justify expansion. However, as discussed above, the regulations should make clear that the underpayment is to be computed across the entire set an MSO's audited systems and underpayments attributable to issues that are

identifiable on the face of the statement of account (such as classification of stations or other issues reviewed by the Copyright Office) should not be considered in assessing the amount of the underpayment. Expansion of an audit should not hinge on issues for which an audit was not necessary.

Similarly, underpayments attributable to reasonable disagreements about issues of law, construction of regulations, or accounting procedures should not give rise to expansion of the scope of an audit. Once such disagreements are identified, they should be capable of resolution without the imposition of additional audit costs and burdens on either party.

Finally, the Copyright Office should establish a procedure for resolving good faith disputes over legal, regulatory and accounting issues before an audit is expanded. The system operator should have the opportunity to have its position heard and considered and, if the system operator is determined to be wrong, to cure any defects in its other systems, without bearing the burden of an expanded audit.

AT&T opposes any provision for the expansion of audit limits in a regulation that provides for cost shifting. Such a context invites expansion of an audit to increase the likelihood that costs will be shifted.

VI. The Time Limits Set Forth in the Proposed Rule Are Unreasonably Short.

The Proposed Rule includes numerous unrealistic time requirements. These should be modified to comport with business realities. First, the regulation should make clear that on-premises work is disfavored, and any on-premises work that is required must be conducted with reasonable notice during reasonable business hours.

Second, a licensee will likely need more than 30 days to respond to an audit request and gather the requested information. A 60-day initiation period is more reasonable. Moreover, the that 60-day initiation period should not run during the period starting 75 days prior to the due date of semi-annual statements of account (the "Statement Preparation Period"), when the individuals with the most knowledge are fully occupied meeting filing requirements.

Third, the licensee should have 45 days to review the draft report with its own accountants and staff prior to consultation with the auditor and, if the auditor and licensee continue to disagree following a reasonable period of consultation (which may involve more than one meeting), the licensee should be provided with 60 days to prepare a written response, a period that the licensee should be permitted to extend by 30 days, if the 60-day written response period overlaps with the Statement Preparation Period. The 14-day period set forth in the Proposed Rule is wholly inadequate. During that 60-day written response period, the licensee should also be permitted to resolve any disputes, remedy any alleged errors, and cure any alleged underpayment that it may wish to resolve, remedy or cure. The regulation should make clear that such remediation and cure does not constitute licensee's admission that the prior reports and payments were

wrong. The remedying of errors and the period of time for the auditor to provide a report to the copyright owners should be expanded to correspond to these periods.

VII. Confidentiality

Auditors conducting STELA audits will have access to highly confidential proprietary, competitive information that is not available to, or reasonably determinable by, AT&T's competitors. Such information may include, for example, market-specific information concerning revenues, subscriber levels, and of service provided. AT&T is careful to protect such information, and requires its content providers and auditors working for those content providers to enter into strict confidentiality agreements protecting its information. Such information, if made public or if provided to a competitor, could have significant adverse competitive consequences to AT&T. Competitors could use the information, for example, to design and target competing service tiers to lure customers from U-verse.

Congress made clear its intent that licensee confidential information should be "safeguard[ed]" under the Register's regulations. Thus, the regulations should provide strong confidentiality protection to licensee information provided to the auditor. The Proposed Rule is a start, but it should be significantly strengthened. Auditors should be required to execute an enforceable agreement in favor of the licensee to be bound by the confidentiality regulation. The regulations (or the enforceable agreement) should recognize the risk of irreparable injury and provide for the availability of injunctive relief and monetary damages in favor of the licensee. Auditors who violate confidentiality agreements should, in addition to other remedies available to the licensee, be barred from further STELA audit work for a period of three years.

The class of individuals to whom the auditor may disclose confidential information set forth in paragraph (m)(2)(ii) ("Authorized Recipients") should be further limited (beyond the limitations included in the Proposed Rule) to those individuals are engaged in the audit and require access in order to perform their duties in connection with the audit. Further, the limitation on employees, officers and agents of copyright owners should extend to affiliates of copyright owners and to employees, officers and agents of any licensee under section 111 or section 119, or affiliates thereof. In addition, the confidentiality agreement between the auditor and such Authorized Recipients must be no less protective of the licensee's information than the protection provided in the regulation (or the agreement between the auditor and the licensee), and the agreement must expressly be for the third party benefit of the licensee.

AT&T agrees with the initial instinct of the Register that, as in most of the Office's other audit regulations, access to confidential information should be limited to the auditor and should not be made available to copyright owners. This is particularly important in the context of STELA, in light of the relationship between competing cable system operators and copyright owners (e.g., Comcast's relationship with NBCUniversal).

Moreover, explicit limitations should be imposed on the information that may be disclosed to copyright owners in an audit report. The report must not confidential information.

CONCLUSION

AT&T appreciates the efforts of the Copyright Office to protect the interests of STELA licensees and urges the Register to modify the Proposed Rule as discussed in these comments.

Respectfully submitted,