

SOUNDEXCHANGE ANNUAL REPORT FOR 2016 PROVIDED PURSUANT TO 37 C.F.R. § 370.5(c)

SoundExchange, Inc. (“SoundExchange”) is a 501(c)(6) tax exempt organization incorporated in Delaware and headquartered in Washington, D.C. It is overseen by an 18 member board of directors, with half representing sound recording copyright owners and the other half representing featured and non-featured recording artists. SoundExchange was incorporated on September 22, 2003.

The presentation of financial information in this annual report is intended to comply with SoundExchange’s requirements under 37 C.F.R. § 370.5(c) and is not intended to be a presentation in accordance with generally accepted accounting principles.

Royalty Collection

Statutory

Services paying royalties to SoundExchange are generally doing so under rates and terms established by the Copyright Royalty Board or published in the Federal Register pursuant to the Webcaster Settlement Acts.

Services availing themselves of the statutory license are able to do so by operation of law and are not “SoundExchange licensees” even though they are frequently referred to as such. Congress created a statutory regime under which any service complying with the statutory and regulatory conditions may obtain a license via federal statute. This license permits such services to reproduce and transmit sound recordings lawfully released to the public without having to negotiate directly with the copyright owner for the rights to those recordings.

During 2016, SoundExchange was the sole entity designated by the Copyright Royalty Board to collect royalties paid by services operating under the statutory licenses set forth in Sections 112 and 114 of the Copyright Act and the implementing regulations established thereunder. (17 U.S.C. §§ 112 & 114; 37 C.F.R. Parts 370, 380, 382, 383 and 384). The services paying royalties to SoundExchange fall into the following statutorily defined categories:

- Preexisting Subscription Services
- Preexisting Satellite Digital Audio Radio Services
- Eligible Nonsubscription Transmission Services
- New Subscription Services (e.g., subscription webcasters; certain cable or satellite television music distribution services)
- Services exempt from liability for transmissions to business establishments under 17 U.S.C. § 114(d)(1)(C)(iv) but liable for ephemeral phonorecords made to facilitate such transmissions (“Business Establishment Services”)

Royalty Distribution

In accordance with the applicable regulations, SoundExchange generally allocates a service's royalties on a pro rata basis in accordance with the information provided in the service's reports of use. For example, if the net royalties (after deducting costs) paid by Service A total \$100 for period X and Service A reported 10,000 discrete sound recordings during that period with identical usage reported for each track, then each distinct sound recording would be valued at one cent (\$0.01) ($\$100 \div 10,000$).

Royalties may remain undistributed when there is an ongoing legal proceeding, including appeals, which may alter a previously established rate. Royalties may also remain undistributed if SoundExchange has not received reports of use information, if reports of use are received but have faulty data, or if the Copyright Royalty Board has not approved a proxy in lieu of actual reports of use data.

The royalties paid by a service are allocated on a nondiscriminatory basis. Each sound recording is valued equally. SoundExchange allocates all royalties received for domestic performances equally among **all** featured artists and copyright owners, regardless of whether or not they have executed appropriate membership documents with SoundExchange. Any potential payees must provide appropriate registration documents to SoundExchange prior to receiving any royalties owed to them. There is no fee for registering with SoundExchange.

The performance royalties collected by SoundExchange are allocated according to the percentages set forth in Sections 114(g)(2)(A)-(D) of the Copyright Act. *See* 17 U.S.C. §§ 114(g)(2)(A)-(D).¹ The statute requires that:

- (A) 50 percent of the receipts shall be paid to the copyright owner of the exclusive right under section 106(6) of the Copyright Act to publicly perform a sound recording by means of a digital audio transmission.
- (B) 2½ percent of the receipts shall be deposited in an escrow account managed by an independent administrator jointly appointed by copyright owners of sound recordings and the American Federation of Musicians or any successor entity) to be distributed to non-featured musicians (whether or not members of the American Federation of Musicians) who have performed on sound recordings.
- (C) 2½ percent of the receipts shall be deposited in an escrow account managed by an independent administrator jointly appointed by copyright owners of sound recordings and the Screen Actors Guild-American Federation of Television and Radio Artists (or any successor entity) to be distributed to non-featured vocalists (whether or not members of the American Federation of Television and Radio Artists) who have performed on sound recordings.

¹ In accordance with the statute, SoundExchange distributes 100% of the royalties collected pursuant to 17 U.S.C. § 112(e) for the ephemeral copy of the phonorecord to the copyright owner.

- (D) 45 percent of the receipts shall be paid, on a per sound recording basis, to the recording artist or artists featured on such sound recordings (or the persons conveying rights in the artists' performance on sound recordings). 17 U.S.C. §§ 114(g)(2)(A)-(D).

Royalties among a "featured artist" are generally allocated on a pro rata basis unless all of the members of a featured artist instruct SoundExchange as to an alternative allocation. By this we mean, for example, that where the featured artist is a band with four members, each member shall be entitled to 25% of the featured artist's share absent their full agreement on different ratios. When the members of a featured artist disagree as to the appropriate allocation of royalties, SoundExchange puts all royalties for that featured artist on hold pending resolution of the dispute. All such royalty disputes must be resolved outside of SoundExchange.

Pursuant to the provisions of Section 114(g)(3) of the Copyright Act, SoundExchange deducts from its receipts, prior to their distribution, the reasonable costs incurred in:

- (A) the administration of the collection, distribution, and calculation of the royalties;
- (B) the settlement of disputes relating to the collection and calculation of the royalties; and
- (C) the licensing and enforcement of rights with respect to the making of ephemeral recordings and performances subject to licensing under section 112 and [section 114], including those costs incurred in participating in negotiations or arbitration proceedings under section 112 and [section 114], except that all costs incurred relating to the section 112 ephemeral recordings right are only . . . deducted from the royalties received pursuant to section 112. *See* 17 U.S.C. § 114(g)(3).

SoundExchange distributes royalties directly to copyright owners and featured artists when provided with the information necessary to effectuate payment. SoundExchange may also distribute royalties to featured artists and copyright owners pursuant to reciprocal payment agreements with foreign collecting societies when those artists and copyright owners have appropriately authorized SoundExchange to undertake this activity. For example, SoundExchange may pay the Dutch collecting organization all of the royalties due the featured artists and copyright owners who have designated the Dutch organization to collect U.S. statutory royalties on their behalf. As part of that exchange, SoundExchange may also collect from the Dutch organization all the royalties due to featured artists and copyright owners that have designated SoundExchange to collect Dutch royalties on their behalf. SoundExchange may also consider paying a portion of a featured artist's royalties to a third party involved in the creative process of making a sound recording (e.g., a producer, engineer, or mixer) under a letter of direction received from a featured artist as an accommodation to such featured artist.

When SoundExchange is unable to distribute allocated royalties to either a copyright owner or featured artist, those royalties are held for the copyright owner or featured artist pending further attempts to effectuate payment.

SoundExchange expends significant resources to reduce the amount of allocated but undistributed royalties. Under the applicable regulations, SoundExchange retains all such undistributed royalties for not less than three years from the date of the initial distribution of the royalties, and thereafter may use such royalties to offset its costs.

Key Financial Statistics

The following table summarizes SoundExchange's operating administrative rates, royalty collections, gross distributions and expenses.

(\$ in millions)	2016	2015	2014
Operating Administrative Rate	5.3%	4.6%	4.6%
Total Royalties Collected²	\$952	\$888	\$788
Total Gross Distributions	\$884	\$803	\$773
Total Expenses	\$52	\$41	\$36

² Statutory royalties in 2016 were \$822 compared to \$846M for 2015, down 2.8%. The remaining collections represent royalties received from non-statutory services (primarily from non-statutory licensing arrangements between sound recording copyright owners and services performing the works of those sound recording copyright owners, settlement administration and foreign collective management organizations). Statutory royalties are typically paid 45 days following the end of the month in which the liability accrued.