



June 3, 2008

## MEMORANDUM TO CLIENTS

**Re: Copyright Office Issues Notice of Proposed Rulemaking on Application of Cable Compulsory Copyright License to Retransmission of Digital Broadcast Signals.**

The Copyright Office today issued a Notice of Proposed Rulemaking (“NPRM”) soliciting comment on a number of proposed policy determinations regarding the application of the cable compulsory copyright license (17 U.S.C. Sec. 111) to the retransmission of digital broadcast signals. The issues addressed in the Notice include the reporting and calculation of royalties for digital multicast streams, the application of the 3.75% rate to digital signals, the inclusion of fees for digital equipment and second set connections in the gross receipts on which royalties are based, and the status of digital audio broadcast stations under Section 111.

As summarized in greater detail below, the Office generally has concluded that the carriage of distant digital signals, including digital multicasts (other than simulcasts) must be separately reported and paid for and that equipment fees and other charges associated with the reception by subscribers of digital broadcast signals must be included in an operator’s gross receipts calculation. Many of the Office’s proposals are interpretations of existing rules and do not require minimal, if any, changes in those rules. Taken individually and as a whole, the Office’s rulings – if adopted in a final order – are likely to increase the amount of royalties that many cable operators will have to pay for retransmitting broadcast signals going forward.

**Background.** In 2005, several copyright owners petitioned the Copyright Office to commence a rulemaking proceeding to address various issues arising under the cable compulsory license with respect to the retransmission of digital broadcast signals. The petition specifically asked the Office to clarify that cable operators are required to report on their statements of account, and separately pay for, digital multicast signals that the operator carries as “distant signals.” The petition also requested that the Office amend its rules and forms to instruct cable operators to separately determine whether a digital signal (including each digital multicast stream) is a network or non-network signal and whether the signal is “permitted” or “non-permitted” for purposes of computing compulsory license royalties. Finally, the petition asked the Office to adopt rules clarifying that a cable operator’s “gross receipts” calculation (which provides the base on which royalties are calculated) should include (i) any fees charged subscribers for converters used to receive HDTV or other digital broadcast signals; (ii) any additional set fees charged to customers to receive digital broadcast signals; and (iii) any revenues from digital tiers that a customer is required to “buy through” as a condition of receiving the digital broadcast signals.

In September 2006, the Office responded to the copyright owners' petition by issuing a "Notice of Inquiry" ("NOI"). The Office resolved one threshold issue in the NOI by holding that while digital broadcasting was unknown when Congress enacted the cable compulsory license in 1976, the statutory provision was not format-specific and thus no statutory change was necessary to bring the retransmission of digital broadcast signals under the coverage of the compulsory license. With respect to the other issues raised by the owners' petition, the Office sought comment from interested parties. In general, the comments filed by the copyright owners supported reporting and calculating royalties for each multicast stream and for including all fees associated with the retransmission of digital broadcast signals. The cable industry argued against such interpretations and suggested that the Office should await further guidance from Congress.

**Policies Announced in the NPRM.** The Office's NPRM reaches fairly definitive conclusions with respect to most of the issues raised in the NOI and seeks comment on those conclusions. As summarized below, the positions adopted by the Office are generally adverse to the cable industry's interests:

■ **Pre-Transition "Dual Carriage"**

Most broadcasters currently transmit both an analog and a digital version of their stations and many cable operators retransmit both of these signals. To the extent that the broadcast station is "local," the carriage of two versions of the station does not impact the amount of royalties that an operator has to pay (since the royalties are calculated on the basis of the number and type of distant signals carried, not local). The Office has concluded that cable operators should separately list the analog and digital signals, but that to the extent that a retransmitted distant digital signal merely "simulcasts" the same content as the retransmitted distant analog version of the station, the operator does not have to calculate a separate "DSE" value for the digital signal and its royalties will not be affected by the dual carriage.

■ **Multicasts**

*In General.* With respect to the retransmission of a broadcaster's digital "multicasts" (both pre- and post-transition), the Office found that each multicast stream should be reported and, if distant, paid for as a separate signal. Thus, for example, if a cable operator carried a distant NBC affiliate (e.g., WNBC, channel 4) and three of that station's multicast streams (e.g., an NBC-affiliated weather channel, a news channel, and programming from the CW network), the operator's Statement of Account would separately list WNBC-DT (channel 4.1), WNBC-DT2 (channel 4.2), WNBC-DT3 (channel 4.3), and WNBC-DT4 (channel 4.4). Each of these signals would be assigned a "distant signal equivalent" ("DSE") value based on its particular characteristics. Because NBC is a network for purposes of the compulsory license, WNBC-DT would be assigned a DSE value of 0.25. The streams carrying local news programming and CW programming would be "independent" stations for purposes of the compulsory license and would have to be accounted for at the value of 1.0 DSE each. The NPRM does not clearly indicate how the NBC-affiliated weather channel would be treated; resolution of that issue may depend on the outcome of another, long-pending petition concerning what constitutes a "network" station for purposes of the compulsory license.

*Program-related multicasts and ancillary streams.* While the general rule is that multicast stream must be reported and accounted for with its own DSE value, there are a few exceptions to this general rule. One, as indicated above, is where, during the transition, the digital stream simulcasts the programming on the station's analog signal. The other exception involves situations in which the broadcaster is using a multicast stream to deliver programming

that is “program related” with respect to another one of the streams. For example, if one multicast stream is used to present sports programming and the other stream offers an interactive version of the same channel that allows the viewer to choose the camera angle, only one of those streams would have to be accounted for as a separate DSE.

#### ■ **Determination of “Local Service Area” of Distant Signals**

For the most part, if a broadcast station was deemed to be “local” with respect to a particular cable system for purposes of the compulsory license while it was broadcasting in analog, its digital signal will also be “local” with respect to that system. However, there are exceptions to this general rule. First, because the traditional analog “Grade B contour” is not used to measure the signal coverage area of a digital station, the Office has determined that where an analog station’s “local” status was based on its Grade B contour, the digital station will not be deemed local unless it qualifies under one of the other tests. This ruling could have a significant effect on the carriage of noncommercial stations, which currently are deemed local with respect to cable community units that are wholly or partially within 35 miles of a designated “reference point” for the station or wholly or partially within the station’s Grade B. Going forward, the local service area of digital non-commercial station will be based only on its 35-mile zone. Second, stations that are deemed “significantly viewed” with respect to the area served by a cable operator are treated as local for copyright purposes. The Office agrees that the significantly viewed status of an analog station carries over to its primary digital signal. However, the Office will not treat multicasts of a significantly viewed signal as themselves significantly viewed absent a clarification of how the FCC will treat such signals.

#### ■ **Permitted/Non-Permitted Status of Digital Signals (3.75% Rate)**

At the time the compulsory license was enacted in 1976, the FCC maintained a set of distant signal “quota” rules that limited the number of distant signals that an operator could carry. The quota varied depending on the type of signal (network, independent, non-commercial), the size of the market in which the cable operator was located, and other factors, including grandfathering, Grade B coverage, etc.). Following the repeal of the FCC’s distant signal quota rules, a separate 3.75 % rate was applied to the carriage of formerly “non-permitted” distant signals. The Office has determined that the 3.75% rate should be applied to digital signals (including digital multicasts) as if the signal quota rules were still in place. Thus, using the NBC example from above, if the system carrying the distant NBC affiliate and three of its digital multicasts was only entitled to carry one independent station, then the distant digital multicast streams carrying CW programming and local news programming would each cost the system 3.75% of its gross receipts (assuming that the system is already carrying its quota of independent stations).

There are, as noted, several factors that can influence whether a particular station is deemed permitted or non-permitted, even if its carriage would otherwise exceed the applicable quota. For example, over-quota signals that are entitled to “permitted” status include (i) “specialty” stations; (ii) grandfathered stations; (iii) commercial UHF stations within their Grade B contour; (iv) non-commercial educational stations; and (v) stations carried pursuant to a quota-era waiver from the FCC. According to the Copyright Office, a digital station that simulcasts the programming of an analog “specialty” station is permitted, but non-simulcast multicasts of a specialty station must separately establish that they qualify as permitted specialty stations. Similarly, a simulcast digital version of a grandfathered signal also will be grandfathered, but other non-simulcast multicast streams will be non-permitted. For the same reason that the “Grade B contour” standard will no longer be used to determine the local service area of a non-

commercial station, the Office has determined that any digital counterpart of an analog station that was deemed permitted based on its signal strength contour will, all other things being equal, be treated as non-permitted and subject to the 3.75% rate. In the case of non-commercial stations and, at least in some instances, stations deemed permitted pursuant to a waiver, the permitted status of the analog station will carry over to the digital version of the station.

#### ■ **New Digital Only Signals/Downconverted Digital Signals**

The discussion up to this point has focused on stations that are (or at one point were) broadcasting in analog as well as digital. However, there are some stations that were originally licensed by the FCC as digital stations that have never had an analog counterpart. Generally speaking, the same rules as described above will apply to new digital-only signals. Obviously, this would not be the case where the digital signal's status is dependent on the status of its analog counterpart.

The Office also determined that the downconversion of a digital signal into an analog format is inconsequential to the application of the compulsory license. Thus, if a cable operator downconverts a digital signal to analog, it only will have to report the signal once even if it retransmits the downconverted version in addition to the digital version.

#### ■ **Digital Service Fees**

The generally applicable rule under the compulsory license is that an operator must include in its gross receipts calculation any fees that are charged to a subscriber as a prerequisite to receiving a package of services containing a broadcast signal. The copyright owners contend that many cable operators include digital broadcast signals on a separately-priced digital tier or require the subscriber to purchase an expanded basic tier before they can receive digital signals. While the cable industry argued that cable operators generally do not require the payment of additional service fees to get access to retransmitted digital broadcast signals (although an additional equipment charge may be levied), the Office agreed with the copyright owners that if a charge for service is imposed as a precondition for obtaining a digital broadcast signal, revenues from such charges (whether they are an intermediate tier buy-through, a "gateway" charge, or a charge for a digital tier) must be included in the gross receipts computation.

#### ■ **Equipment Charges, Second-Set Fees and Home Networking**

An issue that the Office addressed that may turn out to be particularly significant concerns the reporting of receipts from equipment used to access digital broadcast signals, second set fees and home networking charges. The "correct" treatment of equipment charges has been a matter of dispute between cable operators and copyright owners for many years and has been the subject of somewhat contradictory opinions from the Copyright Office. On the one hand the Office has said (and copyright owners argue) that all of the revenues from equipment that is used to access broadcast signals must be included in the gross receipts calculation, even if the subscriber could view the broadcast signals without that equipment or with a less expensive piece of equipment. Cable operators, on the other hand, take the position that, at very least, an operator that offers more than one equipment option only has to report equipment revenues based on the lowest-priced piece of equipment made available.

Thus, for example, if the operator had simple non-addressable box for which it charged \$2 and more sophisticated addressable box for which it charged \$4, most operators, relying on a Copyright Office opinion letter, would take the position that they only have to include \$2 per box in the gross receipts computation. Some operators go further and argue that since broadcast use a “cable ready” set that can pick these signals up without leasing any equipment from the cable operator, no converter revenues need to be included in the gross receipts computation. The Office’s NPRM rejects this latter approach, but does not squarely address the issue of whether a cable operator that offers a \$4 digital cable box and a \$6 HD/DVR box can include only \$4 per box in its gross receipts calculation.

The Office also indicated that operators must include revenues for the lease of CableCards if the card is used to access broadcast signals. Because broadcast signals, except in unusual circumstances, cannot be encrypted, CableCards generally are not used to access broadcast signals and thus, revenues associated with the cards do not have to be reported. Finally, the Office concluded that any second set service fees that a subscriber must pay (apart from fees for additional pieces of equipment) in order to gain access to digital broadcast signals must be included in gross receipts, along with any fees received for “home networking” services that allow subscribers to view programming on multiple sets with only a single converter box. The Office’s discussion of second set service fees and home networking services is not completely clear; in particular, despite some ambiguity in the discussion, we believe that the Office’s position does not require a cable operator to include second set charges if a subscriber is able, with the appropriate equipment, to access all of the system’s broadcast signals without paying a separate second set service charge.

#### ■ **Digital Audio Broadcasting and Internet Retransmissions**

The cable compulsory license allows cable operators to retransmit broadcast radio stations, either on a discrete channel basis or on an “all-band” basis. With the advent of digital audio broadcasting (“DAB”), the Office decided that clarification of the application of Section 111 to this new technology was in order. Because cable operators do not have to pay royalties for the retransmission of radio stations, the only issues raised with respect to DAB are whether it is covered and whether revenues received from subscribers for a DAB retransmission service need to be included in an operator’s gross receipts. The answer to both of these questions is yes.

Lastly, the Office declined to address comments that sought a ruling to the effect that the compulsory license applies to the retransmission of broadcast signals over the Internet by means of a service that limits access to subscribers in the station’s local market. The Office stated that issues relating to the retransmission of broadcast signals via the Internet will be addressed in a separate Report to Congress that the Office is scheduled to complete by the end of June 2008.

As noted, the conclusions reached by the Office are tentative in the sense that the public now has the opportunity to comment on them (comments are due July 17; replies are due September 2). Please do not hesitate to contact this office, if you have any questions regarding this matter.

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