

July 3, 2008

MEMORANDUM TO CLIENTS

Re: Copyright Office Recommends Phase Out of Cable and Satellite Distant Signal Compulsory Copyright Licenses.

On June 30, 2008, as required by Section 109 of the Satellite Home Viewer Extension and Reauthorization Act of 2004 (“SHVERA”), the Copyright Office delivered to the House and Senate Judiciary Committees a report analyzing the cable (Section 111 of the Copyright Act) and satellite (Sections 119 and 122) compulsory copyright licenses and making recommendations for revisions to those licenses. The Office’s Report, which is intended to provide some guidance to Congress as it considers whether to renew the DBS compulsory license (which is scheduled to expire at the end of 2009), recommends that Congress replace the current DBS and cable compulsory license provisions with a “unified” license under which DBS providers and cable operators both would enjoy a royalty-free compulsory license for local signals and would pay a per subscriber, per signal “flat fee” for the retransmission of a limited number of distant signals. This unified license would sunset in five years.

A brief summary of the principal conclusions and recommendations contained in the Office’s 227-page report is as follows:

A. Principal Recommendation: Adopt a “unified” royalty-free local license for cable and DBS and phase out the cable and DBS distant signal licenses.

The Office’s Report contains a number of sweeping (and often debatable) conclusions regarding the impact that changes in the video programming marketplace and video distribution technology have had on the need for compulsory licensing of broadcast signal retransmissions by cable and DBS. For example, the Office concludes that, as a result of the development of new platforms such as the Internet, there is less interest in distant signal programming. Among the Office’s other findings:

- The cable and DBS industries are “no longer dependent upon distant signals” and thus repeal of the license would not have the “dramatic” effect it would have had in the past.
- The economic rationales for the licenses are “waning and less justifiable” given the success of the Internet.
- There are “many types of private mechanisms that have developed” that can replace the compulsory licenses, including sublicensing (by broadcasters) and collective licensing (an ASCAP-like model); the fact that cable operators have “cleared the rights” to carry hundreds of non-broadcast cable networks demonstrates that it would not be impossible for cable operators to negotiate with copyright owners to carry two or three distant broadcast signals.

Despite the Office's confidence that compulsory licensing for distant signals is no longer necessary or desirable, the Report acknowledges that immediately eliminating access to distant signals could be disruptive to viewers and distributors. Therefore, the Office recommends that Congress enact a distant signal license applicable to both cable and DBS that is limited in duration and scope. This new "unified" compulsory license provision also would provide cable and DBS with a royalty-free license to retransmit local broadcast signals (but would not change the broadcasters' right to demand compensation for retransmission consent). Some of the details of the proposed new license are as follows:

- Local and distant signals for both the cable and DBS would be determined by reference to Nielsen DMAs.
- Significantly viewed signals and local radio stations would be covered by the local license.
- The local license also would apply to the retransmission of network signals from adjacent, in-state DMAs to subscribers in a county assigned to an out-of-state DMA.
- The number of distant signals covered by the compulsory license would be capped – up to four distant network signals could be carried as necessary to fill in "gaps" in the local signal complement plus one distant independent signal.
- The definition of a "network" that currently applies to the DBS compulsory license (and which covers ABC, NBC, CBS, PBS and Fox) also would apply to cable (which currently is required to treat Fox as an independent station). Although the Report specifically states that the CW, Univision, and Trinity would be "non-network" under this definition, we believe that the Office's assumption in this regard may not accurately reflect the total hours of network programming currently offered by these distributors.
- Royalty payments would be calculated on the basis of a flat, per subscriber/per signal monthly fee (payable every six months). A separate rate schedule would apply to cable operators with 1,000 or fewer subscribers. The fee would be set by the Copyright Royalty Board based on a "fair market value" standard unless the copyright owners and users agree to rate.
- Retransmission consent would continue to apply to the carriage of local and distant signals. The exemption from retransmission consent granted to DBS for the carriage of distant network signals to "unserved" households would be repealed along with the unserved household provision. Instead, both DBS and cable would be required to comply with similar network non-dup, syndex, and sports blackout rules. The Office has not recommended that cable's "must carry, must buy" obligations be harmonized with the DBS "carry one, carry all" regime for local signals.
- Copyright owners would be given a "simple, but effective" right to audit the books of cable operators and DBS providers to check the accuracy of royalty payment calculations.
- The unified license (at least with respect to distant signals) would sunset in five years; copyright users and owners would be required to begin negotiating a "marketplace" solution in 2014.

B. Alternative Proposal: Retain separate distant signal licenses, but amend them to address competitive disparities.

The Office's Report (in apparent recognition of the fact that the affected industries have, for the most part, not supported the adoption of a "unified" cable/DBS compulsory license) offers a fall back proposal. Specifically, if Congress decides to retain separate compulsory license provisions for cable and DBS, the Office recommends that those licenses should be amended to produce more competitive "harmony" between the two industries. The specific amendments that the Office proposes would result in separate, but very similar, licenses for cable and DBS that closely resemble the distant signal provisions of the "unified" license proposal described above. For example, the Office's fall back proposal recommends that Congress make the following changes to the cable compulsory license:

- Replace the current gross receipts-based formula with a flat fee comparable to the DBS flat fee; cap the number of distant signals that could be carried at four network signals and one independent signal; establish a new small system royalty rate for systems under 1,000 subscribers.
- Clarify that each retransmitted distant digital multicast stream is to be accounted for in calculating royalties.
- If Congress retains the cable compulsory license's current gross receipts-based formula instead of adopting a flat fee approach, the statutory "cable system" definition (which the Office interprets as requiring that commonly-owned, contiguous cable facilities be treated as one system) should be revised in order to address concerns that have been raised about the artificial consolidation and the artificial fragmentation of cable systems for purposes of royalty calculations, the emergence of statewide franchises, and the entry of new competitors such as Verizon and AT&T that are technically configured to operate on a more regional or national basis. However, the Office declined to offer any specific statutory language to address these issues.
- Congress should study whether and to what extent equipment (*e.g.*, set-top) revenues should be included in the gross receipts calculation.
- The issue of "phantom" signals should be addressed by Congress in revising the cable system definition. However, **the Office stated that it no longer supports an amendment that would allow operators to calculate royalties on a subscriber group basis as proposed by NCTA.**
- The cable compulsory license's "minimum fee" payment requirement (which the Office concluded creates an unjustifiable competitive imbalance with DBS) should be repealed, but only as part of a larger, flat fee based revision to the current cable license provision. Similarly, the so-called 3.75% rate, which the Office concluded is "outdated," should be eliminated, but only in connection with the adoption of a cap on the number of distant signals that a cable operator can carry pursuant to the license.

The Report also contains a few recommendations for changes to the DBS distant signal license. The changes proposed are similar to those included in the unified license proposal, such as replacing the unserved household limitation with network nonduplication and syndex rules and repealing the DBS industry's retransmission consent exemption for distant network signals. The Office also proposes that certain changes be made to both the cable and DBS licensees, including the grant of an audit right to copyright owners and the adoption of a five year sunset for both licenses. The Office also proposed that it be given the power to establish and collect administrative fees from all users of the compulsory licenses to defray the costs of processing and examining Statements of Accounts.

C. Miscellaneous Proposals.

The Office's Report addresses several other issues, as follows:

- *Royalty rates.* The Office concludes that both cable and DBS are under-compensating copyright holders for the use of their works, citing the prices that cable operators pay for non-broadcast programming. (The Office finds, however, that the retransmission consent market does not provide a good indicator of the value of copyrighted programming). According to the Office, the amount paid in royalties is "insignificant" compared to cable's annual revenues. As noted above, the Report recommends that rates paid by cable and DBS for retransmitting distant signals reflect "fair market value" as determined either by the Copyright Royalty Board or an agreement among the parties.
- *Retransmission Consent.* Although the Report is somewhat critical of retransmission consent, it declines to recommend its repeal.
- *IPTV and Internet Retransmissions.* The Office finds that AT&T and Verizon fall within the definition of a cable system for purposes of the cable compulsory license, but that the regional/national operational structure of these companies does not fit cleanly within the existing compulsory license terms. The Office recommends that Congress condition the eligibility of these services for the cable compulsory license on their compliance with the FCC's rules governing a cable operator's retransmission of broadcast signals (i.e., must carry, network non-dup, syndex, sports black out). However, according to the Report, the existing compulsory licenses do not apply and should not be extended to cover the retransmission of broadcast programming via the Internet, even on a "secure" system such as proposed by Capitol Broadcasting.

As indicated, the Office's Report is intended to provide a guide for Congress in drafting legislation to renew the distant signal compulsory license for DBS (which is scheduled to expire at the end of 2009). While it is unlikely that Congress will start working on such legislation until next year, the publication of the Report likely will serve as a wake-up call for the industries to begin considering what sort of changes they would like to see, or would strongly oppose, in the compulsory license.

We would be pleased to respond to any questions regarding this matter.

FLEISCHMAN AND HARDING LLP