



October 29, 2009

MEMORANDUM TO CLIENTS

Re: House Judiciary Committee Approves Legislation Resolving “Phantom Signals” Issue and Making Other Changes in Cable Compulsory License.

On October 28, the Judiciary Committee of the House of Representatives released the text of legislation previously approved by the Committee (H.R. 3570, the “Satellite Home Viewer Update and Reauthorization Act”), together with the Committee’s explanatory report. The bill not only extends until 2010 the DBS compulsory license (which is set to expire at the end of the year), but also makes several changes in the cable compulsory license. For example, the bill resolves the so-called “phantom signal” issue, adjusts the generally applicable royalty rates upward by five percent, and provides for the imposition of filing fees and the establishment of a procedure by which semi-annual statements of account and royalty payments could be “audited” by copyright owners.

Phantom Signals. A phantom signal issue occurs when a cable operator offers a distant signal in some, but not all, of the communities served by a single system. Cable operators have argued that they should only have to pay copyright royalties for the signal based on revenues from communities where the signal is actually carried, whereas the content owners have argued that cable operators should be forced to pay for the signal based on revenues from all customers in the system, regardless of whether the signal is actually carried in all communities.

Under the bill approved by the House Judiciary Committee, cable operators will be allowed to use a subscriber group methodology when calculating royalties for phantom signal situations. Just as a cable operator may now use subscriber groups to distinguish signals that are local in some areas of a cable system but distant in others, cable operators will be able to use subscriber groups on the Statement of Account to distinguish distant signals that are carried in some communities served by a cable system but not carried in others.

The House Judiciary bill also makes clear that cable operators that previously used subscriber groups in phantom signal situations are not subject to infringement liability arising out of their past use of that approach. However, cable systems that did not use the subscriber group methodology on Statement of Accounts filed prior to the bill’s enactment will not be entitled to seek refunds or offset any current or future royalty payments by using subscriber groups to re-calculate royalties for those previous accounting periods.

Royalty Rates. Current law allows the copyright owners to seek an “inflation” adjustment in the cable royalty rates during 2010. The legislation preempts that adjustment procedure by adopting a five percent increase in the current rates, effective with the first

accounting period of 2010. This increase is less than two previous inflation adjustments. The bill does not change the rates or the gross receipts thresholds for smaller systems.

Audits. Under the bill, copyright owners will be able to conduct audits, using a qualified independent auditor, to verify gross receipts and royalty fee computations reported on a cable operator's Statement of Account. All copyright owners electing to conduct an audit must use the same auditor, thereby assuring that a cable operator's Statement of Account for a particular accounting period cannot be reviewed more than once. The bill instructs the Register of Copyrights to adopt further regulations to govern the audit process, including rules addressing how frequently often a system can be audited and how many systems operated by an MSO can be audited in a single year. Cable operators will be permitted to review the auditor's report before it is disseminated to the copyright owners, and the bill directs the Register of Copyrights to ensure that cable operators are allowed to amend the Statement of Account and make any necessary additional copyright royalty fee payments upon reviewing the auditor's report. If the cable operator pays in full a deficiency identified by the audit, the operator will be immune from infringement liability in connection with that deficiency (absent evidence that the deficiency was the product of bad faith by the operator). If the operator disagrees with the auditor's conclusion and does not amend its form as recommended, the operator may face an infringement action and, if a court finds that the operation underpaid its royalties, could be subject to damages.

Filing Fee. The bill also directs the Register of Copyrights to establish a filing fee to be paid in connection with the deposit of semi-annual Statements of Account with the Copyright Office. According to the House Judiciary Committee, the fee is designed to recoup the costs of the administration of the statutory copyright licenses without needing to deduct these costs from the copyright royalties disbursed to copyright owners. The Register of Copyrights is directed by the bill to minimize the impact of the fee on smaller cable systems.

Digital Transition. The bill makes certain revisions in the cable compulsory license in response to the broadcast digital transition. For example, the bill clarifies that each distant multicast signal carried by a system must be reported and paid for as a separate "distant signal equivalent." In addition, the bill addresses situations where a station's local/distant or permitted/non-permitted status is determined by analyzing whether a particular community falls within a station's analog Grade B contour. Because the Grade B contour is not used to measure the strength of a digital broadcast signal, the bill provides for the use of the "noise-limited contour," which is the comparable digital signal strength measurement, to make these determinations.

Next Steps. At this time, the House Judiciary Committee is working with the House Commerce Committee, which has approved a separate bill addressing the Communications Act-related provisions of the satellite reauthorization legislation, to combine the two committee bills for referral to the full House of Representatives. Among other things, it is anticipated that the final bill will provide additional guidance regarding the treatment of multicast signals under the cable compulsory license, including certain grandfathering and transitional provisions. The Senate Judiciary Committee has approved a similar bill that contains essentially identical

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provisions relating to phantom signals and rates, but does not address the audit, filing fee, or digital transition issues. When finalized, the Senate Judiciary bill likely will be combined with a bill from the Senate Commerce Committee and, to the extent necessary, the House and Senate versions of the bill will be reconciled. It is our expectation that the provisions described above adopted by the House Judiciary Committee will be very close to those that are eventually passed into law.

We would be pleased to respond to any questions regarding these matters.

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