Before the
Library of Congress
Copyright Office
Washington, D.C.

In the matter of:	)	
	)	
Section 109 Report to Congress	)	Docket No. RM-2007-1

COMMENTS

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SUMMARY

Ten years ago, the Copyright Office reported to Congress that aspects of the cable compulsory license were "***burdensome***," "***unfair***," and resulted in "an ***irrational*** and ***unjustified*** disparity in payments." The Copyright Office recommended reforms to address these problems. In the intervening 10 years, Congress has failed to act on these recommendations. The Section 109 Report provides the Copyright Office with a singular opportunity to send a message loud and clear to Congress – <u>Fix the problems with Section 111</u>. A regulatory regime that is unnecessarily burdensome, unfair, and irrational, offends fundamental values and polices underlying our rule of law. Neither the Copyright Office nor Congress should tolerate this.

The Section 109 Report should recommend specific reforms to Section 111. Four changes would go far in rectifying the problems:

1. Congress should eliminate the use of the outdated FCC "market quota" rules for carriage of networks and independent stations.

   Almost three decades ago, the FCC rescinded its market quota rules. Yet the Copyright Office still bases royalty calculations on these rules. Example 1 on pages 7 – 9 shows how the old market quota rules result in one of two identical cable systems paying <u>**285%**</u> more in copyright royalties solely because it is located 30 miles away from the other system. No rational basis exists for the disparity in payments.

2. Congress should eliminate the "phantom signal" problem so that a cable operator is <u>not</u> obligated to pay royalties on a distant signal where that distant signal is <u>not</u> carried.

   The Copyright Office bases royalty calculations on the following interpretation of Section 111: If a cable operator carries a distant signal on a cable system, it must pay royalties for all subscribers where that signal would be distant, <u>even where the signal is not retransmitted</u>. Example 2 on pages 10 – 12 shows how <u>**58%**</u> of a cable system's royalties results from the *non*-use of just one distant signal. No theory of intellectual property rights supports the payment of license fees for the *non*-use of a copyrighted work.

3. Congress should align the cable compulsory license with the DBS compulsory license by eliminating royalties for retransmission of local signals.

Currently, when a cable operator delivers a package of local signals to one household, and a DBS provider delivers the identical package of local signals to the house next door, the cable operator must pay copyright royalties, while the DBS provider does not. No rational basis remains for this disparity in royalties for local signals.

4. Congress should align the Section 111 definition of "network station" with the section 119 definition of "network station".

   The Copyright Office continues to express doubts over whether it can classify Fox stations as "network" stations under the cable compulsory license, while it is clear the Fox stations are "network stations" under the DBS license. Harmonizing the definitions will remove this doubt.

These changes would eliminate many of the administrative burdens and much of the unfairness and irrationality of the current cable compulsory license.

In addition, the Copyright Office should recommend retaining the short-form, flat fee regime for smaller cable systems. For a very small and shrinking segment of the industry, this approach continues to serve to reduce administrative burdens and help small rural systems provide broadcast signals to consumers.

By making these recommendations to Congress, the Copyright Office can advocate for long overdue reform and help advance the core policies underlying the cable compulsory license.

American Cable Association. ACA represents nearly 1,100 small and medium-sized cable companies that serve about 8 million cable subscribers, primarily in smaller markets and rural areas. ACA member systems are located in all 50 states, and in virtually every congressional district. The companies range from family-run cable businesses serving a single town to multiple system operators with small systems in small markets. All ACA members retransmit broadcasts signals under the cable compulsory license and have a keen interest in the reform of Section 111.

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I. INTRODUCTION

Nearly 10 years ago, the Copyright Office undertook a comprehensive study of the cable compulsory license and issued to Congress a well-crafted and insightful report.[1] In the *1997 Report*, the Copyright Office described aspects of the cable compulsory license as "***burdensome***" and "***unfair***."[2] Going further and citing comments by a small cable company, the *1997 Report* concluded that problems with the cable compulsory license resulted in "an ***irrational*** and ***unjustified*** disparity in payments."[3] In the intervening 10 years, despite these conclusions by the Copyright Office, Congress has failed to reform Section 111. This legislative inaction has perpetuated a regulatory

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[1] *A Review of the Copyright Licensing Regimes Covering Retransmission of Broadcast Signals*, A Report of the Register of Copyrights (Aug. 1, 1997) ("*1997 Report*").

[2] *Id.* at 42 ("[T]he administrative complexity of the current cable rates is burdensome, and in many respects, unfair. Many hours are spent by cable systems just to understand how much they owe and how to fill out the forms (which often requires legal advice).").

[3] *Id.*, citing Comments of St. Croix Cable (filed Apr. 26, 1997) ("*St. Croix Comments*") (emphasis added).

regime that the expert agency charged with oversight has described as burdensome, unfair, and irrational.

With that in mind, we turn to this proceeding.

Concerning the cable compulsory license and its impact on small and medium-sized cable companies, the Copyright Office must use the Section 109 Report to communicate the following messages to Congress:

- The cable compulsory license remains the most efficient mechanism to clear copyrights on the retransmission of broadcast signals.

- As reported by the Copyright Office ten years ago, aspects of the cable compulsory license remain "burdensome," "unfair," and result in "an irrational and unjustified disparity in payments." These attributes offend fundamental policies and values that shape our government and laws – administrative efficiency, fairness, rationality, and equality under the law.

- Congress must reform Section 111. A failure to do so will perpetuate unfairness, irrationality, and unnecessary administrative burdens.

The Section 109 Report can build upon this foundation and recommend specific reforms to Section 111. Four changes would go far in rectifying the problems:

1. Eliminate the use of the outdated FCC "market quota" rules for carriage of networks and independent stations.

2. Eliminate the "phantom signal" problem by clarifying that a cable operator is not obligated to pay royalties on a distant signal where that distant signal is not carried.

3. Align the cable compulsory license with the DBS compulsory license by eliminating royalties for retransmission of local signals.

4. Align the Section 111 definition of "network station" with the Section 119 definition of "network station."

In addition, the Copyright Office should recommend retaining the short-form, flat fee regime for smaller cable systems. For a shrinking segment of the industry, this approach continues to serve to reduce administrative burdens and help small rural systems provide broadcast signals to consumers.

II. ANALYSIS

A. The cable compulsory license remains an efficient means to clear copyrights on the retransmitted broadcast signals, but Congress must reform Section 111 to eliminate unnecessary burdens, unfairness and irrational disparities in payments.

The NOI asks if the circumstances warranting the creation of the cable compulsory license in 1976 continue to exist.[4] From the perspective of small and medium-sized cable companies, the answer is unequivocal – **yes.**

Negotiating separate copyright licenses for each copyrighted work in each broadcast signal would overwhelm small and medium-sized cable companies. ACA members report that negotiating satellite programming and retransmission consent contracts alone impose major administrative burdens on their limited resources. Unlike satellite program contracts, however, a retransmission consent agreement does not convey a license to retransmit most of the copyrighted works in a broadcast signal. Similarly, carriage under must carry conveys no rights to copyrighted works in a broadcast signal. As a result, for the typical small or medium-sized cable system carrying between seven and twelve broadcast stations, without a compulsory license, each cable operator would have to negotiate literally hundreds of separate license agreements.

In comparison to 1976, due to the growth of commercial broadcasting and cable

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[4] *Section 109 Report to Congress*, Notice of Inquiry, 72 Fed. Reg. 19039, 19050 (Apr. 16, 2007) ("*NOI*").

carriage of broadcast signals, the burden that negotiating separate rights agreements would impose has actually increased geometrically. Consequently, the original policies and economic rationale underlying the cable compulsory license apply today with even more force, especially for small and medium-sized cable companies. In the Section 109 Report, the Copyright Office should recommend retaining the cable compulsory license as the most efficient means to clear copyrights and compensate rights holders for retransmission of broadcast signals on cable systems.

While Section 111 continues to serve its overall intended purpose, reform of the compulsory license is sorely overdue. Ten years ago, the Copyright Office, the very agency charged with administering Section 111, stated "[T]he administrative complexity of the current cable rates is burdensome, and in many respects, unfair," resulting in "an irrational and unjustified disparity in payments."[5] In the decade between then and now, nothing has changed. The Section 109 Report provides a critical opportunity for the Copyright Office to send the following message to Congress with force: Fix the problems with Section 111.

For many ACA members, much of cable copyright's unnecessary burdens, unfairness and irrationality are rooted in two distinct aspects of the current application of Section 111 – the use of outdated FCC "market quota" rules and the "phantom signal" problem. Congress should also update Section 111 to align it with two aspects of the DBS compulsory license: (i) update the definition of "network station" in Section 111; and (ii) harmonize the payment obligations for local signal carriage and eliminate cable royalties for systems that carry only local signals.

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[5] *1997 Report* at 42 (emphasis added).

In the next section, we explain in more detail these four problems and the straightforward solutions the Copyright Office should recommend to Congress.

B. Congress should adopt four specific changes to rectify the problems with Section 111.

The NOI asks if Section 111 should be amended to reflect "the current marketplace" and the FCC's "existing regulatory framework."[6] The answer is manifest – **yes**. In reforming Section 111, Congress must address the unfairness, irrational disparities in payments, and unnecessary administrative burdens. The specific reforms described below would go far in addressing these problems. The Copyright Office should advocate for them in the Section 109 Report.

1. Congress should eliminate the application of outdated FCC "market quota" rules so that all signals permitted to be carried under FCC regulations are permitted under the compulsory license.

The Copyright Office continues to base distant signal royalty calculations on old FCC "market quota" rules.[7] These regulations governed and restricted cable carriage of broadcast signals in the late 1970s. The carriage restrictions in the market quota rules have long been relegated to the waste bin of obsolete proscriptions. The FCC rescinded the regulations 27 years ago.[8]

The old market quota rules limited the number of broadcast signals that cable systems could carry based on the size of the broadcast market served by the cable

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[6] *NOI* at 19052.

[7] 37 C.F.R. § 201.17(h)(5)(ii)(B).

[8] *In the Matter of Cable Television Syndicated Program Exclusivity Rules, Report and Order*, 79 FCC.2d 663 (1980).

system.[9] The following table summarizes the relevant broadcast signal carriage limits under these outdated rules.[10]

Table 1 – Permitted signals under the FCC's old market quota rules

Location of Cable System	Permitted Network Stations	Permitted Independent Stations	Additional Permitted Independent Stations
Top 50 broadcast market	One of each major network	3	2, subject to restrictions
Bottom 50 broadcast market	One of each major network	2	2, subject to restrictions
Smaller broadcast market	One of each major network	1	0

In 2007, the FCC's market quota rules should serve only one purpose – as a historical example of communications regulations that, in the face of technological and marketplace developments, became rapidly obsolete. Beyond that, for cable carriage of broadcast signals today, the market quota rules are irrelevant. After the FCC rescinded the rules in 1980, a cable system could carry as many broadcast signals as it could receive and desired to retransmit. Then in 1992, Congress overhauled broadcast signal carriage laws by imposing must carry and retransmission consent.[11] As a result, for the past 14 years, cable operators must retransmit qualified local signals that demand must carry, while retransmission consent prohibits carriage of local commercial broadcast stations that elect retransmission consent unless the parties reach an agreement on carriage and compensation terms. For out-of-market commercial broadcast stations

[9] 47 C.F.R. §§ 76.57(b), 76.59(b), 76.61(b), 76.63(a) (repealed 1980).

[10] The market quota rules also permitted cable carriage of other broadcast stations, including commercial stations within 35 miles of the cable system, noncommercial educational stations that place a Grade B signal over the cable system, and specialty stations.

[11] *See* Cable Television Consumer Protection and Competition Act of 1992, 106 Stat. 1460, 1471, 1482 (1992), codified at 47 U.S.C. §§ 534, 535, 325(b).

(except the few superstations), carriage under retransmission consent remains the only permissible means of carriage.

Despite this, the current application of Section 111 continues to keep the long deceased market quota rules on regulatory life support. This has a major impact on royalty calculations, especially for smaller market cable systems. Example 1 below demonstrates this, comparing two identical cable systems separated by only 30 miles.

Example 1: Royalty calculations showing how application of the old FCC market quota rules results in a 285% disparity in royalty payments for identical cable systems.

System description. Here we consider two hypothetical small cable systems in Southeast Missouri, System A and System B.[12] The systems are nearly identical. Each system serves 5,000 subscribers and charges $34/month for basic cable. Each cable system carries the local broadcast stations from its DMA, in this example, the Paducah-Cape Girardeau-Harrisburg DMA. Each system also carries two distant signals – WGN, the satellite-delivered superstation from Chicago, and KVTJ, a religious station from Jonesboro. Stations like KVTJ are often popular in smaller markets, and the systems are close enough to Jonesboro to pick up the signal either off-air, remotely or via a fiber connection. For copyright purposes, WGN and KVTJ are considered distant independent stations on these cable systems.

The only difference between the systems is a small amount of geography. System A serves communities in Butler County and western Stoddard County. System B's service area begins about 30 miles to the northeast. Map 1 depicts the service

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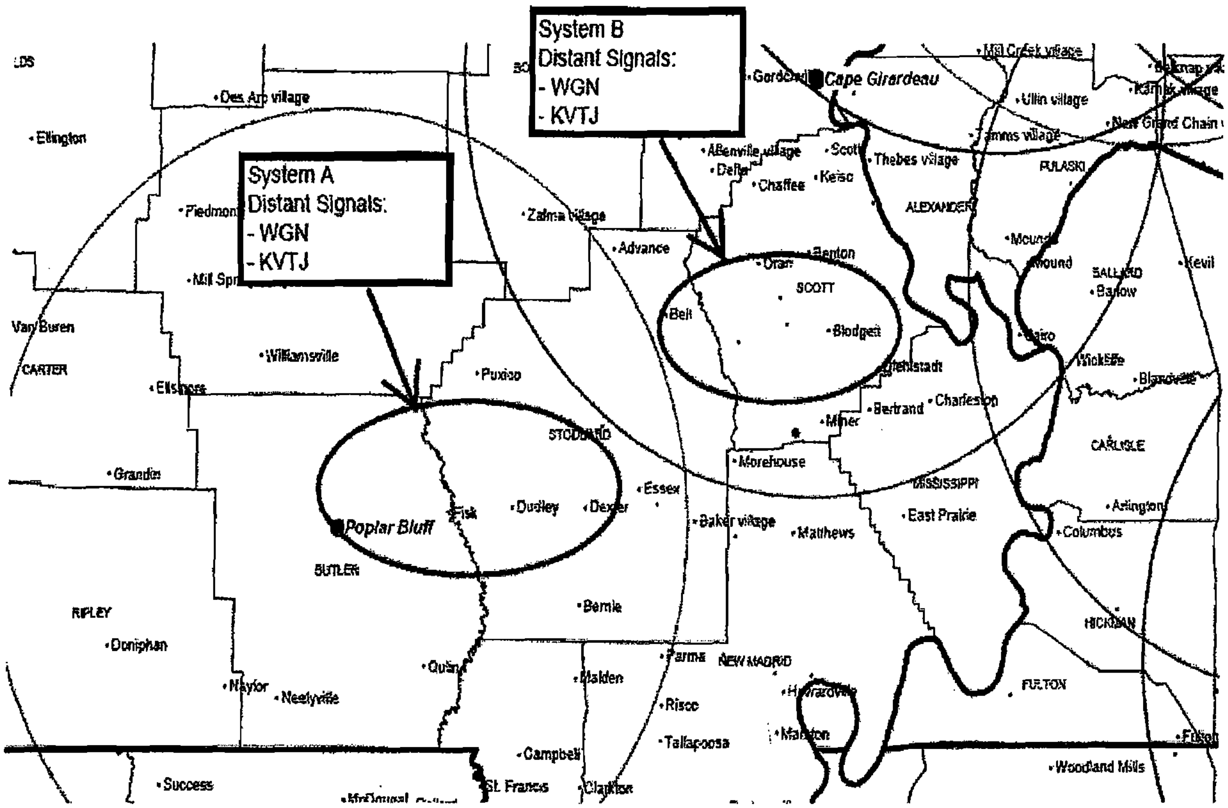
[12] The hypothetical cable systems described here reflect typical attributes of actual ACA member systems serving rural areas and smaller markets throughout the U.S.

areas.

Map 1 - Depiction of Example 1 cable systems



Under the Copyright Office's application of the old market quota rules, a few miles can make an economically excruciating difference. For copyright purposes, System A is in the Poplar Bluff broadcast market, a smaller market where the old rules permitted a cable system to carry only one independent station. System B is in the Cape Girardeau broadcast market, a bottom 50 broadcast market, where a cable system could carry up to four independent stations.

Royalty calculations – 285% disparity between identical systems. The following table summarizes the system information and royalty calculations.

Table 2 – Example 1 royalty calculations

System A		System B	
Location	Butler County, MO/ Stoddard County (west), MO	Location	Stoddard County (northeast), MO/,Scott County (west), MO
DMA	Paducah-Cape Girardeau-Harrisburg	DMA	Paducah-Cape Girardeau-Harrisburg
Broadcast market/size	Poplar Bluff/smaller market	Broadcast market/size	Cape Girardeau-Bluff/bottom 50 market
Subscribers	5,000	Subscribers	5,000
Basic rate	$34/month	Basic rate	$34/month
Semi-annual gross revenues	$1,020,000	Semi-annual gross revenues	$1,020,000
Distant signals carried	WGN (Chicago) KVTJ (Jonesboro)	Distant signals carried	WGN (Chicago) KVTJ (Jonesboro)
Base Rate	$10,332	Base Rate	$17,146
3.75 Fee	$38,250	3.75 Fee	$0
Total Royalties	**$48,582**	**Total Royalties**	**$17,146**
Copyright cost per customer	$1.62/month	Copyright cost per customer	$0.57/month

In this example, solely because of the application of the old market quota rules, System A and its customers pay <u>**285% more**</u> in copyright fees than System B. The only difference between the systems? <u>About 30 miles</u>. And this example involves only one "non-permitted" independent station. The disparity increases geometrically as distant independent stations are added to both systems.[13]

No policy supports this disparity. In the Copyright Office's words, it is "*irrational*." The Section 109 Report should make the strongest possible recommendation to Congress to fix this problem. Congress should amend Section 111 to provide that any

[13] *St. Croix Comments* at 8 ("St. Croix Cable and its customers must pay over <u>385% more in copyright fees for the same programming</u>.").

broadcast signal carried in compliance with FCC regulations is permitted, and not subject to additional "non-permitted" fees.

2. Congress should eliminate the "phantom signal" problem by clarifying that a cable operator is not obligated to pay royalties where a distant signal is not carried.

The "phantom signal" problem leads to an even stranger outcome than the old market quota rules. Under the Copyright Office's interpretation of Section 111, cable operators in certain situations are obligated to pay royalties on distant signals based on revenues from subscribers who do not receive those distant signals. Put another way, cable operators must pay for a license for the *non*-use of copyrighted works. No theory of intellectual property rights supports an obligation to pay for a license for works *not* used.

The phantom signal problem results from the following interpretation of Section 111 by the Copyright Office: If a cable operator retransmits a distant signal *anywhere* on a cable system, royalties must be paid for all portions of the cable system where the signal is distant, even where the signal is not carried.[14] In short, a royalty obligation for *non*-use. As the following example illustrates, the phantom signal problem can lead to an inexplicable result - a cable system paying *more* royalties for distant signals *not* carried than for distant signals actually carried.

Example 2 – Royalty calculations showing how the phantom single problem results in a cable system paying 58% of total royalties for the *non*-use of one phantom signal.

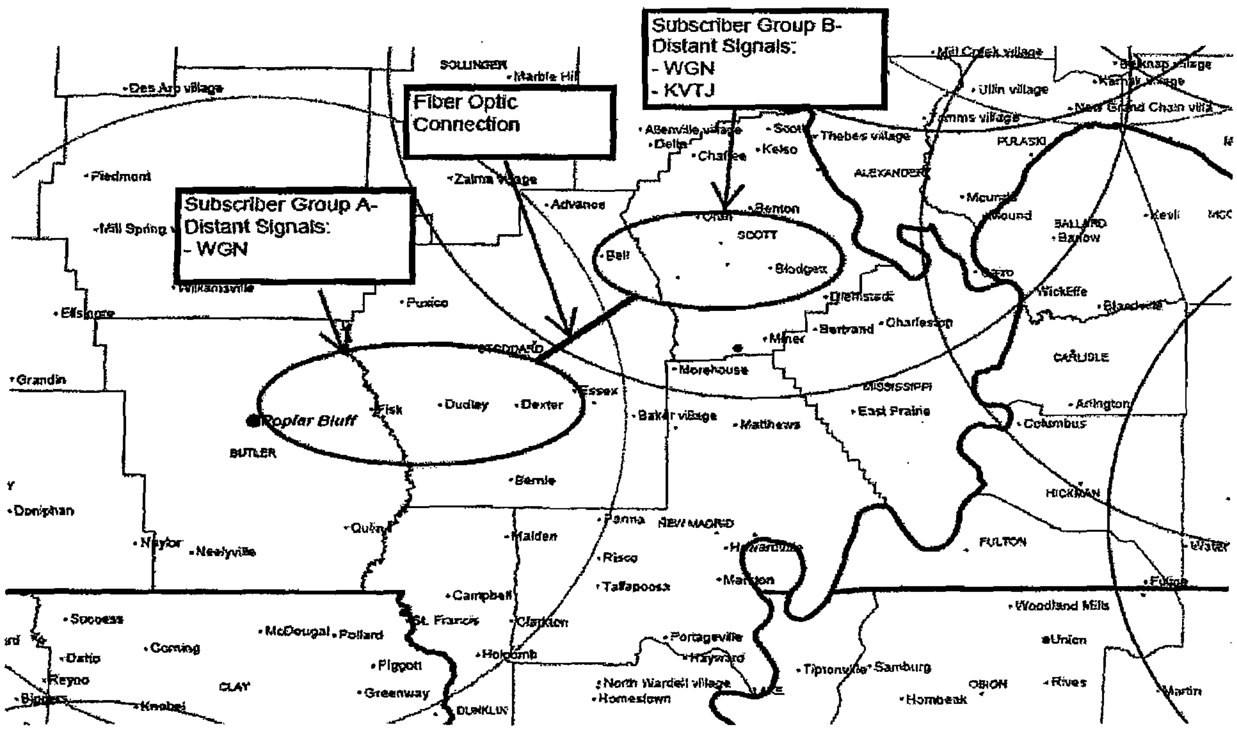
For this example, we return to the two systems in Example 1 and change the facts slightly. First, System A does not carry KVTJ, one of the two distant independent

[14] *1997 Report* at 45-46.

stations carried by the system in Example 1. Then the owner of System B purchases System A, connects the systems with fiber optics, and eliminates System A's headend. For copyright purposes, the formerly separate systems now become one cable system.

The copyright situation becomes slightly more complicated because it is necessary to divide the subscriber base into subscriber groups. In our case we will have two subscriber groups, Subscriber Group A, located in Butler County/Stoddard County (west), and Subscriber Group B, located in Scott County/Stoddard County (northeast). The map below depicts this.

Map 2 –Depiction of Example 2 cable system and subscriber groups



By dropping one distant independent station from the Subscriber Group A, one would expect royalties related to that station would also go away. <u>Not so</u>. KVTJ in Subscriber Group A becomes a "phantom signal." Under the current application of the compulsory license, if a cable operator carries a distant signal on a system, it must pay royalties for <u>all</u> subscriber groups where that signal is distant, even if <u>not</u> carried. As the following table summarizes, **<u>58%</u>** of the system's copyright royalties result from the *non*-use of KVTJ in Subscriber Group A.

Table 3 – Example 2 royalty calculations

Interconnected cable system with Subscriber Groups A and B	
System location: Subscriber Group A Subscriber Group B	 West Missouri - Butler County/Stoddard County Northeast Missouri - Scott County/Stoddard County
DMA	Paducah - Cape Girardeau - Harrisburg
Broadcast market/size: Subscriber Group A Subscriber Group B	 Poplar Bluff/smaller market Cape Girardeau/ bottom 50 market
Subscribers: Subscriber Group A Subscriber Group B	 5,000 5,000
Basic rate: Subscriber Group A Subscriber Group B	 $34/month $34/month
Semi annual gross revenues: Subscriber Group A Subscriber Group B	 $1,020,000 $1,020,000
Distant signals carried: Subscriber Group A Subscriber Group B	 WGN WGN, KVTJ
Royalties for Subscriber Group B: Base rate 3.75 fee	 $17,146 $0
Royalties for Subscriber Group A: Base rate 3.75 fee (due to phantom signal)	 $10,332 $38,250
Total royalties	$65,729
Percentage of royalties from phantom signal	**58%**

As Example 2 demonstrates, the phantom signal problem results in payments of sharply increased royalties based on subscriber groups where the signal is <u>not</u> distributed. Royalty payments for phantom signals epitomize the unfairness and irrationality of the current application of the compulsory license. While we maintain that Section 111 does not mandate this result, the Copyright Office apparently feels bound by this interpretation of the statute.[15]

The Section 109 Report should make the strongest possible recommendation to Congress to fix this problem. Congress should amend Section 111 to clarify that a cable operator is only obligated to pay royalties on revenues derived from the actual retransmission of a signal to subscribers. For any given distant signal, revenues from subscriber groups that do not receive a distant signal should be excluded from royalty calculations.

3. Congress should align the cable and DBS compulsory licenses by eliminating royalties for retransmission of local signals.

The Section 109 Report should include a comparison of the cable and DBS compulsory licenses and an analysis of whether differences are justified.[16] Concerning royalty calculations, the Copyright Office should address at least one key disparity between Section 111 and Sections 199 and 122 – cable operators must pay royalties even if they retransmit only local signals, while DBS providers pay no royalties for the same local signals. If there ever were a basis for this disparity, it has long since evaporated in the heat of intense competition between cable and DBS.

This difference in cable and DBS compulsory licenses leads to an unsupportable result. Consider two neighboring households, one receiving cable service, the other receiving DBS. Both households subscribe to the same package of local broadcast stations. Neither service includes any distant broadcast signals. In this case, a

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[15] *1997 Report* at 46 ("[T]he Office has previously stated that [fixing the phantom signal issue] could not be accomplished administratively because the Office lacked the authority to alter the structure of the cable rates as they are established in Section 111.").

[16] *NOI* at 19040.

common one in many broadcast markets, the cable operator filing an SA-3 must pay a minimum fee of about 1% of gross revenues of the basic tier. At the same time, the DBS operator delivering the same broadcast signals to the house next door pays nothing.

No rational basis exists for this disparity. As Section 122 demonstrates, Congress has concluded that owners of copyrighted works on broadcast signals are sufficiently compensated for local retransmission of their signals without compulsory license payments. The same analysis applies to cable retransmission.

In the Section 109 Report, the Copyright Office should highlight this disparity and recommend elimination of the minimum fee for cable systems that do not carry distant signals.

4. Congress should align the cable and DBS compulsory license by replacing the Section 111 definition of "network station" with the Section 119 definition of "network station".

Reform of Section 111 should also include an update to the definition of "network station" to align the Section 111 definition with the Section 119 definition.[17] At issue is how to classify Fox stations for cable copyright purposes. As the NOI indicates, the Copyright Office remains uncertain whether it should classify Fox stations as network stations or independent stations when calculating royalties.[18] While we believe the Copyright Office has ample basis to conclude that Fox is a network station when retransmitted by a cable system, amending Section 111 by adding the Section 119

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[17] *See* 17 U.S.C. §§ 111(f), 119(d)(2).

[18] *NOI* at 19049 ("Fox, for example, is considered a network station for Section 119 purposes, but it is unclear whether it can be considered a network station for Section 111 purposes.").

definition of "network station" would remove doubts that apparently linger.

The Copyright Office's uncertainty over classification of Fox stations under Section 111 involves more than semantics. In cases where a Fox station is a distant signal, base rate royalties attributable to the station increase **400%** if it is classified as an independent rather than a network station.[19] A Fox station meets all tests for classification as a network signal under FCC regulations, and Congress should amend Section 111 to reflect that.

By adopting the four straightforward reforms described above, Congress would eliminate many of the administrative burdens and much of the unfairness and irrationality in the cable compulsory license. The Section 109 Report should recommend them with force.

C. Congress should retain the short-form, flat fee regime for smaller cable systems.

The NOI asks if Congress should change the royalty structure for smaller cable systems using the SA1-2.[20] For ACA members, the answer is unequivocally **no**. To the contrary, the Copyright Office should strongly recommend retention of the SA1-2 rate structure and simplified filing protocol. The modest relief provided by the SA1-2 benefits a small and shrinking segment of the industry serving primarily rural areas, in many cases areas served by few or no local broadcasters. As small rural cable systems are interconnected, or in some cases, shut down, the scope of SA1-2 relief continues to

[19] When calculating royalties, each distant network signal adds a multiplier of .25, while each independent adds a multiplier of 1.0, hence a 400% increase when a station is considered an independent instead of a network. *See* 37 C.F.R. § 201.17.

[20] *NOI* at 19052-53.

dwindle. The impact on the royalty pool has always been small and is increasingly de minimis. As described in the NOI, a very real possibility exists that any changes that significantly increase royalty payments could lead to a loss of broadcast service for rural cable subscribers.[21]

The small system relief continues to serve its intended purposes for a shrinking segment of the industry, and the Section 109 Report should recommend maintaining the current SA1-2 filing regime and rate structure.

III. CONCLUSION

The Section 109 Report provides the Copyright Office with a singular opportunity to advocate for badly needed reform to Section 111. As described in these comments, four specific reforms would go far in addressing the unnecessary administrative burdens, and rectify unfairness and irrational disparity in payments in the current cable compulsory license.

1. Eliminate the use of the outdated FCC "market quota" rules.
2. Eliminate the "phantom signal" problem by clarifying that a cable operator is <u>not</u> obligated to pay royalties on a distant signal where that distant signal is <u>not</u> carried.
3. Align the cable compulsory license with the DBS compulsory license by eliminating royalties for retransmission of local signals.
4. Align the Section 111 definition of "network station" with the Section 119 definition of "network station."

The Copyright Office should recommend that Congress enact these amendments with dispatch.

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[21] *Id.* at 19052 ("Small cable operators may experience a significant increase in royalty payments under a flat fee system. This increase in turn could lead to a loss of broadcast service for rural cable subscribers that lack the variety of broadcast stations found in the top 100 television markets.").

The Copyright Office should also recommend that no changes be made to the SA1-2 regime for very small cable systems. This regime provides a measure of relief for an increasingly small segment of the cable industry.

Respectfully submitted,

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