ANNOUNCEMENT

from the Copyright Office, Library of Congress, Washington, D.C. 20559

NOTICE OF POLICY DECISION

COMPULSORY LICENSE FOR CABLE SYSTEMS: REPORTING OF GROSS RECEIPTS

The following excerpt is taken from Volume 53, Number 18 of the Federal Register for Thursday, January 28, 1988 (pp. 2493 - 2495)

LIBRARY OF CONGRESS

Copyright Office

[Docket No. RM 86-1]

37 CFR Part 201

Compulsory License for Cable Systems; Reporting of Gross Receipts

AGENCY: Library of Congress, Copyright Office.

ACTION: Notice of policy decision.

SUMMARY: The Copyright Office of the Library of Congress issues this notice to inform the public regarding implementation of the decision of the United States Court of Appeals for the District of Columbia in *Cablevision Systems Development Company* v. *Motion Picture Association of America, Inc.*, No. 86-5552 (D.C. Cir. Jan. 5, 1988), as that decision affects the Copyright Office's administration of the cable compulsory licensing scheme [1] established at section 111 of the Copyright Act of 1976. The notice advises cable systems to report their "gross receipts" for accounting period 1987-2 in accordance with 37 CFR 201.17(b)(1), and informs them that the Copyright Office will require corrected filings, as appropriate, for accountings period prior to 1987-2. The Office also clarifies its interpretation of the "gross receipts" regulation as it applies to "discounts" and "tie-in" arrangements.

EFFECTIVE DATE: January 28, 1988.

FOR FURTHER INFORMATION CONTACT: Dorothy Schrader, General Counsel, Copyright Office, Library of Congress, Washington, DC 20559, Telephone (202) 287-8380.

SUPPLEMENTARY INFORMATION:

1. Background

Section 111(c) of the Copyright Act of 1976, title 17 of the United States Code, establishes a compulsory licensing system under which cable systems may make secondary transmissions of copyrighted works. The compulsory license is subject to various conditions, including the requirement that cable systems comply with provisions regarding the filing of Statements of Account and the deposit of statutory royalty fees pursuant to section 111(d) of the Act.

On April 2, 1984, the Copyright Office issued final regulations (49 FR 13029) that included a clarifying amendment to the Copyright Office definition of "gross receipts for the 'basic service of providing secondary transmissions of primary broadcast transmitters.'" (37 CFR 201.17(b)(1)). In issuing this amendment, the Copyright Office confirmed its 1978 interpretation that the Copyright Act does not allow cable systems to allocate gross receipts or the distant signal equivalent (DSE) value where any secondary transmission service is combined with nonbroadcast service and is offered to cable subscribers for a single fee. Cablevision Company and the National Cable Television Association ("NCTA") challenged that interpretation before the U.S. District Court for the District of Columbia.

On July 31, 1986, the district court held the Copyright Office's regulation defining "gross receipts" invalid, yet did not specify an alternative method for calculating royalties under section 111(d). *Cablevision Company* v. *Motion Picture Association of America, Inc.*, 641 F.Supp. 1154 (D.D.C. 1986). On August 25, 1986, the Office issued an interim regulation (51 FR 30214) establishing new reporting and recordkeeping requirements for cable systems pending the appeal to the Court of Appeals for the District of Columbia Circuit, and any necessary rulemaking. The Copyright Office considered the views of the public concerning the interim regulation and, making two minor changes to the regulation, issued it in final form on December 17, 1986 (51 FR 45110).

On January 5, 1988, the Court of Appeals for the District of Columbia Circuit reversed the district court's holding with respect to the validity of the Copyright Office's April 2, 1984 "gross receipts" regulation. The Court held that "the Copyright Office has the authority to issue regulations interpreting the statutory language at issue and . . . its interpretation was a reasonable one." Based on these holdings, the Court determined that "the district court erred in declining to defer to the Copyright Office's regulation as to what revenues make up 'gross receipts.' " *Cablevision Systems*

[1] Error; line should read: "compulsory licensing program"

Development Company v. *Motion Picture Association of America, Inc.*, No. 86-5552, slip. op. at 4 (D.C. Cir. Jan. 5, 1988).

The Copyright Office is publishing this policy decision to notify the public as to how the Office intends to implement the D.C. Circuit's decision. The Office provides guidance to cable systems and the public in three areas: (1) Cable systems' calculation of "gross receipts" for accounting period 1987-2 (regarding secondary transmissions made during the period from July 1, 1987 through December 31, 1987); (2) certain cable systems' recalculation of "gross receipts" and payment to the Copyright Office of any amounts underpaid for accounting periods prior to 1987-2; and (3) clarification of the Copyright Office's interpretation of the gross receipts regulation as it applies to "discounts" and "tie-in" arrangements.

2. Calculation of Royalties for 1987-2

The D.C. Circuit reversed the district court's holding in the *Cablevision* litigation and affirmed the validity of the Copyright Office definition of "gross receipts" at 37 CFR 201.17(b)(1) as a reasonable interpretation of the Copyright Act of 1976. The Office therefore considers that regulation to be effective as a binding interpretation of the Act for cable systems calculating gross receipts for accounting period 1987-2 (and for prior accounting periods, as discussed below). The Office did not revoke the gross receipts regulation pending the appeal and informed cable systems that the Office believes the regulation represented the correct interpretation of the Act. Accordingly, cable systems should calculate gross receipts pursuant to the regulation and the directions on the Statement of Account forms issued by the Copyright Office. *Cable Systems should disregard Space P (Declaration of Gross Receipts) on Statement of Account Forms SA1-2 and SA3* already mailed to them.

The office considers 37 CFR 201.17(k), [2] the transitional regulation issued on December 17, 1986 in light of the district court's decision, to be inapplicable to section 111 filings made after the issuance of the D.C. Circuit's reversal decision. The regulation was issued to ensure that cable systems that refused to follow the Office's gross receipts regulation because of the district court's decision in *Cablevision* would keep adequate accounting records so that, at the conclusion of the appellate process and any necessary rulemaking, those cable systems would have the tools to recalculate royalties owed for the affected accounting periods (beginning with the 1986-1 period) pursuant to a valid regulation. The D.C. Circuit affirmed that the April 2, 1984, regulation is valid, so the need for the declaration and recordkeeping requirements no longer exists for systems filing for accounting period 1987-2 and thereafter. Henceforth, cable systems will not be in compliance with the requirements of the cable compulsory license if they calculate royalties based upon their own definition of "gross receipts" and fail to comply with 37 CFR 201.17(b)(1). The Office is not revoking 37 CFR 201.17(k) at this time, however, and those cable systems that allocated gross receipts should retain the records of their methods and calculations for the five years set forth in the transitional regulation, unless the Office later issues a notice that the records are no longer needed.

3. Recalculation of Royalties for 1987-1, 1986-2, 1986-1, or Previous Accounting Periods

The D.C. Circuit's decision has eliminated the confusion created by the district court's invalidation of the Copyright Office's definition of "gross receipts" and the subsequent absence of any approved system for the calculation of gross receipts. The Office, therefore, intends to begin the administrative steps leading to collection of any underpayments of royalties caused by a cable system's calculation of gross receipts by an unapproved method.

The Copyright Office is in the process of preparing a brief form to be used by cable systems for amending statements filed in accounting periods 1986-1, 1986-2, and 1987-1. The Office will attempt to mail these forms to every cable system that indicated on a declaration of gross receipts statement filed pursuant to 37 CFR 201.17(k) that the system did not calculate gross receipts pursuant to the Copyright Office's definition at 37 CFR 201.17(b)(1) for a particular accounting period. The Office will provide filing instructions and deadlines for the filing of this form at a later date.

The Copyright Office is aware that some cable systems chose to disregard the Copyright Office regulation and to calculate gross receipts based upon their own theories of allocation even before the district court issued its *Cablevision* decision. Any cable system that underpaid cable compulsory license royalties for any accounting period due [3] to its application of an interpretation of "gross receipts" that differs from the Copyright Office definition should now file an amended statement of account for every relevant accounting period and submit the amount of royalties underpaid to the Copyright Office.

4. Clarification of the "Gross Receipts" Regulation as It Applies to "Tie-in" Arrangements and "Discounts"

The D.C. Circuit concluded that the Copyright Office's "gross receipts" regulation is reasonable "as applied to calculations involving any tier viewed in isolation." Slip. op. at 30. The Court, however, found unripe for judicial review an ancilliary dispute presented through hypotheticals in the case. That dispute concerned letter responses made by the General Counsel of the Copyright Office to hypothetical questions posed by NCTA regarding the Office's interpretation of the "gross receipts" regulation as it applies to marketing practices styled "discounts" and "tie-ins." Id. With the exception of discounts associated with premium pay cable services, the Office believes the hypotheticals are abstract in nature and do not reflect actual marketing practices of cable systems. Nevertheless, at this time the Copyright Office clarifies its interpretation of the regulation in these instances to give guidance to any cable systems that may decide to offer service packages like those described in the hypotheticals.

The "discount" hypotheticals set forth by NCTA in the *Cablevision* litigation involve a package of tiers sold by a cable system to subscribers for a discounted price—that is, the total price for a package of tiers of cable service is a lesser amount than the sum of the prices of each individual tier. For example, if a cable system offers to subscribers a package of three tiers of cable service for $20, while each tier is individually priced at $8, there is a $4 discount for the package.

The gross receipts problem arises because not all the tiers in a particular package of service may contain broadcast signals. For example, a system may offer tier A, consisting of all broadcast signals, for $10, tier B, consisting of both broadcast and nonbroadcast signals, for $4, and tier C, consisting of all nonbroadcast signals,

[2] Error; line should read:
"The Office considers 37 CFR 201.17(k),"

[3] Error; line should read:
"royalties for any accounting period prior to 1986-1 due"
A notice announcing this correction was published in the Corrections Section on page 3113 of the Federal Register, Volume 53, Number 22, Wednesday, February 3, 1988.

for $9. and also offer a discount package of all three tiers for $22. The DC Circuit suggests in dicta that in these circumstances, the cable system should report $14 of the $22 received from a subscriber to the discounted package as gross receipts because "it would be possible to buy all the broadcast signals, A and B, alone for $14." The Copyright Office agrees that, so long as all of the broadcast signals offered in a discounted package of tiers of cable service are included on one or more of the individual tiers of service comprising the discounted package, and subscribers may actually elect to purchase those individual tiers separate from the tier or tiers in the package containing only nonbroadcast service, then "gross receipts" from subscribers to the discounted package shall be the lesser amount of (1) the sum of the amounts individually charged for every tier in the package that contains one or more broadcast signals, or (2) the price of the discounted package.

The "tie-in" hypotheticals set forth by NCTA in the *Cablevision* litigation involve marketing arrangements whereby a subscriber can purchase one tier only after another has first been purchased. For purposes of the calculation of gross receipts, "tie-in" arrangements necessarily call into question whether origination services are offered "in combination with secondary transmission service for a single fee" so as to require all amounts for the services "tied in" to be included in gross receipts under 37 CFR 201.17(b)(1).

Two kinds of "tie-in" arrangements are relevant for a clarification of the "gross receipts" regulation. Under one kind of "tie-in" (Situation A), a subscriber must purchase a tier of service containing broadcast signals in order to purchase a tier of nonbroadcast service. Under the other (Situation B), a subscriber must purchase a tier of nonbroadcast service in order to purchase a tier containing broadcast signals. In applying the Copyright Office definition of "gross receipts" to Situation A, it is clear that a subscriber may purchase the tier of service containing broadcast signals for a separate fee, and the optional purchase of nonbroadcast service does not interfere with the market valuation of the tier including broadcast signals. The Copyright Office does not suggest, and has never suggested that fees for separately-priced pay cable service should be included in gross receipts just because pay cable can be purchased only by those who subscribe to a tier of service that contains broadcast signals.

However, the Copyright Office is concerned about Situation B, and the regulations require reporting of the gross receipts from both tiers in the reverse kind of "tie-in" arrangement where subscriber receipt of a tier containing broadcast signals is tied to a required purchase of a tier containing only nonbroadcast signals. In this case it is clear that the tier with broadcast signals is not separately priced in the marketplace because consumers do not have a choice of buying the tier with broadcast signals alone for a single fee. By using a Situation B "tie-in" arrangement rather than offering broadcast and nonbroadcast signals on a single tier for one price, or offering each on separate tiers totally independently, a cable system could easily manipulate downward its "gross receipts," if the regulation did not require the total receipts from both tiers to be reported as gross receipts. For example, the system could offer subscribers tier X, consisting of broadcast signals WTBS, WGN and WOR for $1 so long as they purchase tier Z, consisting of nonbroadcast signals (e.g. ESPN and CNN) for $10. For each subscriber to the tied $11 service, the system would assert the right to report $1 gross receipts rather than the $11 that would be reported if the broadcast and nonbroadcast signals were offered together on a single tier, or the amount somewhere in between $1 and $11 that would reflect the market price for a totally independent tier of broadcast signals.

The DC Circuit in dicta noted that, generally, "if a subscriber can buy a given tier without purchasing any others, its nominal price will be at least as great as its value; if the subscriber must purchase another tier to receive the one in question, the latter's price may be understated." *Slip. op.* at 32. Based upon this observation, the Court suggested that in Situation B type "tie-in" arrangements, where subscriber receipt of a tier including broadcast signals is contingent upon purchase of a tier of nonbroadcast signals, subscriber revenues from both tiers of service should be reported as gross receipts for purposes of calculating cable copyright royalties. Id. That is the position on "tie-in" arrangements taken by the Copyright Office as early as July of 1985 in a letter ruling to an attorney representing a cable operator, and the Office confirms that position at this time.

Ralph Oman,
Register of Copyrights.

Approved by:
William Welsh,
Acting Librarian of Congress.

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