Before the
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In the Matter of	)	
Definition of Cable System	)	**Docket No. 2007-11**

PROGRAM SUPPLIERS' REPLY COMMENTS

In accordance with the *Notice of Inquiry*, 72 Fed. Reg. 70529 (Dec. 12, 2007) ("NOI") in the captioned docket, the Motion Picture Association of America, Inc. its member companies, and other producers and distributors of movies, series, and specials broadcast by television stations ("Program Suppliers") submit their reply to the comments filed by the National Cable & Telecommunications Association ("NCTA") and American Cable Association ("ACA").

I. DISCUSSION

A. NCTA Seeks To Overturn The Statutory Royalty Payment Plan.

NCTA's Comments (at 4-5) confirm the validity of the NOI's insight that NCTA's proposed changes to the royalty plan are "seemingly without regard to whether a phantom signal problem exists." NOI at 70531. Indeed, changing "seemingly" to "undoubtedly" would better characterize NCTA's proposal. In its comments, NCTA, in effect, asks to rewrite Section 111 so that operators would be required to pay statutory royalties for the carriage of distant signals only when an operator decides that a given subscriber actually receives those distant signals. NCTA's proposal would override the statutory cable system definition and the DSE value calculation in favor of a plan that would effectively allow each system to minimize its royalty obligations by fragmenting cable systems. *See* NCTA Comments at 4 (disparaging Office's regulations that require contiguous systems to file "a single statement of account even where there are valid and rational grounds for maintaining separate headends"). No doubt, cable operators would argue that reducing royalty payments is a valid ground for maintaining separate headends, which would then, under NCTA's proposal, allow them to file a separate statement of account for each headend. Such reasoning is self-fulfilling and flies in the face of Congressional intent to define the term "cable system" in a way that precludes artificial fragmentation as a means to reduce royalties. Moreover, the outcome of NCTA's plan would be utterly inequitable, particularly since cable operators already pay less than fair market value for works subject to the statutory license.

NCTA seeks to expand its proposal, *see* NCTA Comments at 5 (asking why "relief should be limited" to merger situations), well beyond its earlier position that relief was needed only for merger situations, purportedly so not to stunt the growth of clustering.[1] Perhaps this changed position reflects the fact that clustering and cable system mergers have not been slowed, contrary to NCTA's earlier lament, by the current cable royalty regulations. *See* Program Suppliers' Comments in the instant proceeding ("PS

[1] *See, e.g.*, NCTA's 2005 Petition on Phantom Signal Issue at 2 (referring to a situation where "systems subsequently come under common ownership due to a corporate acquisition or merger"); at 3 (referring to Office's 1997 Report to Congress comment about "the royalty rate some cable systems pay when they merge"); at 5 (noting that the NCTA solution was first proposed in 1983 because "even [then], system mergers were resulting in a growing number of [purportedly] separate systems being treated as one"); at 6 (referring to "the so-called 'merged systems' proceeding"); at 8-9 (referring to increased amount of clustering and "head end consolidation")).

Comments") at 9 (noting that by 2004, four out of every five basic cable subscribers were in a major cable system cluster). With its primary policy justification (stifling of cable clusters) shown to be erroneous and the lack of any ambiguity in Section 111(f)'s definition that could be resolved by a new regulation, NCTA's proposed rewrite of Section 201.17(b)(2) appears as nothing more than a new effort to legitimize artificial fragmentation designed to reduce royalty fees.

NCTA proffers no argument that the Section 111(f) definition of "cable system" can be read to make the presence of a headend a necessary element, rather than an alternative means, of defining a cable system. Both Program Suppliers and Copyright Owners showed that no reasonable reading of the definition supports NCTA's view that the language is ambiguous on that point. Finding no support for its reading, NCTA asserts, nonetheless, that its proposal "can protect against artificial fragmentation and can remain true to the 'cable system' definition" by satisfying Congress' "simple purpose . . . to prevent a single cable system from being artificially separated into multiple systems in order to reduce the amount of royalty fees owed." NCTA Comments at 5-6. NCTA would accomplish this by having operators "combine revenues from separate – but commonly-owned and contiguous – cable systems to determine their filing status." *Id.* at 6.

Putting aside how a system could simultaneously be separate yet contiguous and commonly owned, NCTA incorrectly asserts that Congress' sole concern was that systems could use artificial fragmentation to reduce their royalty fees related to their filing status (*e.g.*, a Form 3 system could be separated into multiple Form 1 and/or Form 2 systems). However, Congress was also concerned that fragmentation could be used to reduce the gross receipts and DSE values used to calculate a system's royalty fees. *See* H.R. Rep. No. 1476, 94th Cong. 2d Sess. 99 (1976) (noting that the cable system definition is to be used to establish both "the *applicable royalty fee and* system classification" by treating systems "in contiguous communities under common ownership or control *or* operating from one headend as one system") (emphasis added). NCTA's proposal does not prevent the use of artificial fragmentation to lower the applicable royalty fee, and thus does not address one of the concerns that led to the statutory definition.

NCTA also argues that Congress did not intend that the definition in Section 111(f) prevent use of artificial fragmentation as a means of improperly reducing applicable royalty fees: "Copyright Office policy, rather than the statutory language, causes royalty calculations to be made [on a system-wide] basis." NCTA Comments at 6-7. NCTA's position is risible. The legislative history clearly indicates Congressional intent to prevent diminished royalty fees by artificial fragmentation, *see* NOI at 70530, and the Office's policy, as expressed in § 201.17(b)(2), is virtually identical to the statutory language. Adoption of its proposal would not, contrary to NCTA's assertion, involve a mere policy change, but would require a rewrite of statutory language, something only Congress can do.

Beyond this legal impediment, NCTA's proposal, if allowed, almost certainly would engender controversy. NCTA apparently would allow operators to choose what is a "separate," albeit contiguous and under common ownership or operation, system on the basis of whatever "makes sense from a business or operational standpoint." NCTA

Comments at 4. Separate, yet contiguous and commonly owned, systems would not be a hypothetical possibility, given that there are over 8,000 headends as compared to only 6,200 reporting cable systems. PS Comments at 11. Under NCTA's proposal, operators in cases where a reporting system has more than one headend, would choose whether the existing reporting system should be fragmented into headend segments, each of which NCTA would identify as a separate system for determining the applicable royalty fee.

To be sure, NCTA would address the obvious problem of a changed filing status in those cases by having "a cable system serving multiple communities use the system's total gross receipts . . . to determine which of the Statement of Account Forms . . . is applicable." NCTA Comments at 6. But even that determination is fraught with uncertainty and possible areas of contention.[2] Even if those problems could eventually be resolved, NCTA would still allow operators to reduce the applicable royalty fees under the current statutory definition by fragmenting their systems into headend segments for determining gross receipts and DSE values. *See* NCTA Comments at 11-12 (showing how NCTA's fragmentation would reduce royalty fees below what is applicable under the statutory plan). Such a result would fly in the face of Congressional concern that artificial fragmentation would be used to reduce the applicable royalty fee.

[2] This proposal fails to answer the question of whether each set of facilities served by a single headend would be considered a separate system for royalty filing purposes. Instead, NCTA's combined revenue plan applies to a "system serving *multiple communities*." Presumably, each separate, albeit contiguous and commonly owned, headend segment, which NCTA would define as a separate cable system, could serve "multiple communities." As a result, NCTA's plan of combining revenues from *multiple communities* leaves open the question of whether each headend segment could file its own SOA rather than being part of an SOA filed on the basis of all the communities served and distant carriage by the combined contiguous, commonly owned or operated headend segments.

In short, NCTA's plan would bestow on operators both the motive and the means to fragment their systems so as to reduce the applicable royalty fees, exactly the situation that the current Section 111(f) definition was intended to prevent. Such a result would unfairly penalize copyright owners, allowing cable operators to contort the statutory license scheme to reduce for their benefit the already limited compensation copyright owners receive.

B. <u>NCTA's Community-Based Royalty Calculation Would Violate § 111's Plan.</u>

The second aspect of NCTA's proposal would tie "royalty payments to the distant signals received in a particular cable community." NCTA Comments at 7.[3] According to NCTA, this proposal "in no way would require a statutory amendment to Section 111." *Id.* Yet, NCTA does not point to any language in Section 111 that permits its community-by-community approach to determining DSE values on a subscriber group basis within the same cable system. Instead, NCTA falls back on its claim "that nothing in the Copyright Act *prohibits* the creation of subscriber groups" for this purpose. *Id.* at 9. As Program Suppliers have explained, when deciding whether a proposed practice can be implemented, the question to be asked is *not* whether the statute prohibits that practice, but whether the statute allows it. PS Comments at 7-8 (citing *Bowen v. Georgetown Univ.*

[3] NCTA states "Program Suppliers supported a very similar method for calculating royalties, reading the Act to permit a community specific payment plan." NCTA Comments at 7. Program Suppliers' proposal, which was advanced at a time when it was thought that Section 111 might be amended, decidedly did *not* read the Act to permit a community specific payment plan that could be applied to all cable systems. Program Suppliers' proposal was, instead, limited to situations where two cable systems that had previously filed statements of account merged, and had not yet provided uniform distant signal transmission throughout the merged system. In those circumstances, Program Suppliers proposed to allow the use of the prior boundaries and distant carriage of the pre-merger systems as a way to tailor the payment plan for what was expected to be the short time during which different distant signals were carried by a merged system, based on Program Suppliers' experience that the vast majority of merged systems carried the same distant signals to all subscribers. Program Suppliers 1989 Comments, Docket No. RM89-2, at 5-6.

Hospital, 488 U.S. 204, 208 (1988); *Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995). Nothing in Section 111 indicates that a "not carried" subscriber group calculation, to borrow NCTA's wording, is allowed.

NCTA's contention that no statutory amendment is required to adopt a "not carried" subscriber group category is belied by its own discussion of the existing subscriber groups allowed by the current regulations: one each for "a non-permitted distant signal, a permitted distant signal, or a local signal." *Id.* at 9. Each of those regulations is anchored on an explicit statutory provision: the permitted, non-permitted subscriber groups rely on Section 801(b)(2)(B) that applies the 3.75% rate only to non-permitted signals,[4] while Section 111(d)(1)(B) allows subscriber groups for partially distant and partially local signals. There is no comparable statutory provision for NCTA's proposed "fourth designation . . . [of] 'not carried'" signals (NCTA Comments at 9) that explicitly allows the use of "not carried" subscriber groups. Consequently, because Section 111 does not exempt "not carried" distant signals from royalty fee payments, no valid basis exists on which to promulgate such a subscriber group methodology for calculating royalties.

NCTA next argues that "calculating royalties based on actual carriage is entirely consistent with the Act's structure," and finds the minimum fee for Form 3 systems to be "a narrow exception to this general principle." NCTA Comments at 10. Outside of that

[4] This also answers NCTA's charge that it "would be strange indeed" to allow use of subscriber groups to determine royalty payments for permitted/non-permitted distant signals, but to require that 3.75% rate be paid for "signals that were not even carried at all in these communities." NCTA Comments at 13 (emphasis omitted). This distinction is not strange at all. Congress clearly required the Office to differentiate between permitted and non-permitted signals so that the 3.75% rate would be applied only to the latter. In contrast, there is no statutory provision that allows the Office to differentiate between carried and "not carried" communities for purposes of calculating royalty fees.

narrow exception, according to NCTA, "the Act is predicated on actual carriage of actual signals." *Id.* No such predicate can be found in Section 111 or its legislative history. Quite the opposite, the flat fees paid by Form 1/2 systems have absolutely nothing to do with the actual carriage of actual signals by those systems. As Form 1/2 systems have comprised over the years between 75%-85% of all systems filing statements of account, this is not a narrow exception. The Form 3 royalty payment plan reflects a political compromise based on competing considerations. The statutory scheme that was negotiated did not tie royalty fees to actual signal carriage any more than it assured that adequate royalty fees would be paid for each retransmitted copyrighted work. H.R. Rep. No. 1476 at 90-91. As a matter of sound policy, the royalty scheme cannot be gerrymandered to provide accuracy for the benefit of cable operators without making a comparable adjustment for the benefit of copyright owners. In sum, there is no basis for NCTA's claim that Section 111's structure revolves around actual carriage, and such a proposal, if adopted, would further prejudice copyright owners.

The disconnect between NCTA's claim that actual carriage should control the royalty plan and should be the basis for calculation of royalty payments is demonstrated by the hypothetical in Set 1, Scenario 1 (NOI at 70537), which NCTA mistakenly asserts shows a phantom signal problem. NCTA uses this hypothetical, involving merger of a Form 2 with no distant carriage and a Form 3 system with distant carriage, for the proposition that "the mere fact that these two systems are combined for filing purposes results in a 900 percent increase in copyright costs for subscribers to System 2 [the Form

2 system]." NCTA Comments at 11.[5] First, Program Suppliers have previously demonstrated in their Section 109 comments that royalty payment obligations of cable operators do not correlate to subscriber fees. *See* Program Suppliers' Section 109 Comments, Docket No. 2007-1, at 8-10. Indeed, cable operators have demonstrated a tendency to raise subscriber fees at a pace that outstrips meager increases in royalty payments required of them under Section 111. *Id.* at 10. Second, NCTA assumes the 900% increase is due solely to phantom signals (*see id.* at 11, n.30), but the same increase would apply post-merger if System 2 carried exactly the same complement of distant signals as System 1 pre- and post-merger. Thus no phantom signal claim could be made based on that hypothetical. To the contrary, the 900% increase would occur due to the extremely low Form 2 flat fee, $1,931 (NOI at 70537), postulated for pre-merger System 2. That flat fee does not change even if pre-merger System 2 carried the same signals as did System 1. The royalty payment increases contained in the Set 1 Scenarios follow exactly the statutory plan intended by Congress, *viz.*, royalties for Form 3 systems are substantially higher than the *de minimis* payments made by smaller systems.

C. <u>ACA Offers No Legal or Factual Support For A New Rule.</u>

Despite ACA's entreaty that the Office "eliminate the 'phantom signal' problem," ACA Comments at 2, it offers no legal authority for the Office to take such action and its purported factual showing of an alleged problem is a carefully designed hypothetical that

[5] While NCTA points narrowly to the fact that the System 2 royalties increased 900% post-merger, it overlooks the fact that the merged system pays no more of its gross receipts as royalties post-merger than did the pre-merger Form 3 system. In other words, in Scenario 1, pre-merger System 1 pays 5.43% of its gross receipts for the distant signals it offers ($29,870 divided by $550,000). Likewise, the post-merger combined system pays 5.43% ($47,521 divided by $825,000) of its gross receipts in royalties.

does not match any real world situation. ACA's Section 109 Comments, which it incorporates into the instant proceeding, make the unsupported assertion that "Section 111 does not mandate" the use of system-wide gross receipts and DSE values in the royalty calculation. ACA Section 109 Comments at 12. ACA offers no textual analysis of Section 111 or other legal support for its view. To the contrary, ACA concedes that the current statutory language supports such system-wide determinations and cannot be changed by a new regulation, but must await Congressional action. *See id.* (asking the Office to "make the strongest possible recommendation to Congress to fix this problem").

ACA states that its Section 109 Comments "show how 58% of a cable system's royalties results from the non-use of just one distant signal." ACA Comments at 2. That statement is misleading, however, because it rests on ACA's unrealistic hypothetical designed to reach a pre-determined result. Program Suppliers showed in their Section 109 Reply Comments that the subscriber and monthly rate premises on which ACA's hypothetical was based have occurred in only a handful of times in the thousands of cable system SOAs filed over the past several years. *See* Program Suppliers' Section 109 Reply Comments, Docket No. 2007-1, at 2-3. Further, the 3.75% signal scenario hypothesized by ACA has never occurred. *Id.* Thus, while the scenario is a testament to ACA's ingenuity in formulating a hypothetical that serves its purpose, it offers no realistic example of a problem that has actually been encountered by cable systems. ACA's hypothetical does not demonstrate the kind of widespread problem that would compel a change in the regulations, even assuming the Office had the authority to make such a change.

In sum, ACA's Comments offer nothing to support NCTA's proposed rewrite of the Section 111 plan through regulation. To the contrary, ACA's recognition that only Congress can make the requested changes to the current royalty calculation regulations suggests that the current rulemaking is the wrong forum for consideration of NCTA's proposal.

II. CONCLUSION

For the reasons stated here and in our initial Comments, Program Suppliers urge the Copyright Office to deny NCTA's petition.

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