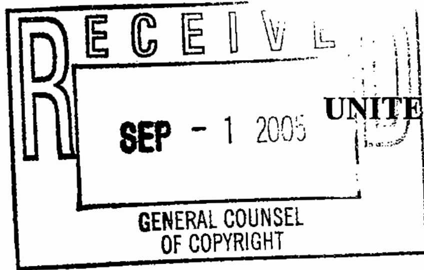
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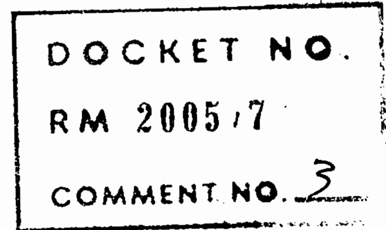
DOCKET NO.
RM 2005-7
COMMENT NO. 3

In the Matter of:

Satellite Home Viewer Extension and Reauthorization Act of 2004

Notice of Inquiry

Docket No. RM 2005-7

COMMENTS OF DIRECTV, INC.

This is, in some ways, an anomalous proceeding.[1] Congress has asked the Copyright Office to prepare a report on the efficacy of a satellite distant signal statutory license that it has just rendered irrelevant to many subscribers.[2] Last December, Congress passed the Satellite Home Viewer Extension and Reauthorization Act ("SHVERA"),[3] which contains several "no-distant-where-local" provisions. These provisions prohibit DIRECTV, Inc. ("DIRECTV") from signing up new subscribers for distant analog or digital signals where it provides local analog or digital signals, respectively.[4] Indeed, even without SHVERA's new provisions, DIRECTV believes that

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1 *Satellite Home Viewer Extension and Reauthorization Act of 2004*, Notice of Inquiry, Docket No. RM 2005-7, 70 Fed. Reg. 39343 (rel. July 7, 2005) ("*Notice*").

2 *See* 17 U.S.C. § 119 (creating a statutory license for satellite operators to retransmit distant broadcast signals); 47 U.S.C. § 338 (containing Federal Communications Commission rules with respect to this license).

3 Pub. L. No. 108-447 § 204, 118 Stat. 2809, 3428-29 (2004).

4 *See* 17 U.S.C. § 119(a)(4)(C) (providing that "[t]he statutory license under paragraph (2) shall not apply to the secondary transmission by a satellite carrier of a primary analog transmission of a network station to a person who – (i) is not a subscriber lawfully receiving such secondary transmission as of the date of the enactment of the Satellite Home Viewer Extension and

distant signals will be less important in the future than they are today. DIRECTV has found that viewers prefer – by substantial margins – their local broadcast signals to similar out-of-town signals.[5] This is why DIRECTV has made delivery of local signals such a high priority.[6]

Nonetheless, significant numbers of DIRECTV subscribers receive distant signals now, and some percentage of them will continue to receive such signals in the future. In this sense, it is entirely appropriate for the Congress to solicit comment on the status of the distant signal license.

The *Notice* seeks comments on two subjects. First, it asks whether the "Grade B" standard is the right standard for determining those who live in "unserved households" (and, relatedly, whether the new digital standard will or should resemble it). Second, it

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Reauthorization Act of 2004; and (ii) at the time such person seeks to subscribe to receive such secondary transmission, resides in a local market where the satellite carrier makes available to that person the secondary transmission of the primary analog transmission of a local network station affiliated with the same television network pursuant to the statutory license under section 122, and such secondary transmission of such primary transmission can reach such person."); 17 U.S.C. § 119(a)(4)(D) (providing that "[t]he statutory license under paragraph (2) shall apply to secondary transmissions by a satellite carrier to a subscriber of primary digital transmissions of network stations if such secondary transmissions to such subscriber are permitted under section 339(a)(2)(D) of the Communications Act of 1934, as in effect on the date after the date of the enactment of the Satellite Home Viewer Extension and Reauthorization Act of 2004, except that the reference to section 73.683(a) of title 47, Code of Federal Regulations, referred to in section 339(a)(2)(D)(i)(I) shall refer to such section as in effect on the date of the enactment of the Satellite Home Viewer Extension and Reauthorization Act of 2004."); 47 U.S.C. § 339(a)(2)(D)(iv) (providing that, "[a]fter the date on which a satellite carrier makes available the digital signal of a local network station, the carrier may not offer the distant digital signal of a network station affiliated with the same television network to any new subscriber to such distant digital signal after such date, except that such distant digital signal may be provided to a new subscriber who cannot be reached by the satellite transmission of the local digital signal").

[5] As DIRECTV has launched local markets, it has seen a marked *decrease* in distant signal subscribership. In each of 2003 and 2004, DIRECTV experienced a net loss of around 170,000 distant network subscribers. Put another way, in early 2002, approximately 16 percent of DIRECTV customers subscribed to at least one distant network signal feed – now the number is under 9 percent.

[6] DIRECTV now retransmits local analog signals in over 130 markets, representing 93 percent of U.S. television households. And it recently announced plans to offer as many as 1500 local digital signals by 2007.

asks whether the license "harms" copyright owners (and therefore, presumably, whether it should be abandoned).

In both respects, DIRECTV generally endorses the *status quo*. While the Grade B standard is not perfect, it is a reasonably good standard for determining whether a household is unserved. The key here, however, is that *predictive models are far preferable to actual measurements* – and Congress should ensure that predictive models can be employed for digital signals.

As for whether the statutory license harms copyright owners, there is no reason to believe the existing system (group negotiation with mandatory arbitration) results in any worse outcome for copyright owners than a post-statutory license system (almost certainly group negotiation with or without arbitration). But there are many reasons to anticipate significant transaction costs – including outright market failures – in any transition to a post-statutory license system. These costs may or may not redound to copyright owners, and in any event, cannot be considered a cognizable "benefit" of abandoning the statutory license.

I. CONGRESS SHOULD ENSURE THAT SATELLITE OPERATORS CAN CONTINUE TO EMPLOY PREDICTIVE MODELS

The *Notice* asks whether the "unserved household" limitation for the delivery of distant network signals, and in particular the "Grade B" standard contained within this limitation, has operated "efficiently and effectively" and whether it has "promoted the goal of protecting copyright owners of over-the-air television programming."[7]

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[7] *Notice*, 70 Fed. Reg. at 39344. *See* 17 U.S.C. § 119(d)(10) (providing that "[t]he term 'unserved household', with respect to a particular television network, means a household that -- (A) cannot receive, through the use of a conventional, stationary, outdoor rooftop receiving antenna, an over-the-air signal of a primary network station affiliated with that network of Grade B intensity as

DIRECTV takes this to be asking whether the Grade B standard allows rapid and accurate determination of whether a particular household can or cannot receive an adequate over-the-air signal from a station of the same network as the proposed distant signal.[8]

The *Notice* also asks "[t]o what extent will the signal intensity standard for households receiving over-the-air digital network stations likely resemble the current standard for analog television" and "[t]o prevent receipt of distant signals by subscribers who can receive an adequate local signal, what, if any, amendments will be necessary to the unserved household definition with respect to [digital signals]?"[9] Of course, to the extent the Grade B standard is in fact "efficient and effective," the new digital standard (now being developed by the FCC) ought to look as much like it as possible.[10] For this reason, DIRECTV's comments on this subject pertain both to analog and digital standards.

With respect to "effectiveness" – *i.e.*, accuracy – of the Grade B standard, DIRECTV has little serious complaint. Certainly, DIRECTV has pointed out that, at the outer limits, some signals of "Grade B" intensity may not be considered adequate in today's world. That said, "Grade B" is a reasonably good standard, and now has the benefit of familiarity.

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defined by the Federal Communications Commission under section 73.683(a) of title 47 of the Code of Federal Regulations, as in effect on January 1, 1999.").

8 *See Notice*, 70 Fed. Reg. at 39344 (noting that the unserved household limitation "was created to prevent satellite carriers from bringing network stations from distant television markets to subscribers and thereby decrease their incentive to watch the signals of the local over-the-air network stations").

9 *Id.*

10 *See* 47 U.S.C. 339(c)(1)(A) (directing the FCC to complete a study with respect to a digital standard); *Technical Standards for Determining Eligibility for Satellite-Delivered Network Signals Pursuant to the Satellite Home Viewer Extension and Reauthorization Act*, Notice of Inquiry, 20 FCC Rcd. 9349 (2005).

The more pressing question, from DIRECTV's point of view, is the "efficiency" of the Grade B standard. It is efficient now only because the Copyright Act specifically provides for the use of a model for *predicting* (as opposed to measuring) whether a household receives a signal of Grade B intensity.[11]

Unfortunately, there is no provision related to predictive models for digital signals. Indeed, the legality of such predictive models has been questioned by broadcasters.[12] According to them, the only way one can determine if a viewer is "unserved" with respect to local digital signals is to conduct on-site testing.[13] This would be terrible public policy. If the "unserved household" standard is to remain "efficient" in the world of digital television, Congress must clarify that a predictive model is acceptable, if not mandatory.

By way of background, on-site testing is far from the norm today. In the last five years or so, only about 3,200 DIRECTV customers – or only 0.3 percent of those requesting distant network signals – asked for an on-site test. Only about 1,400 of these actually received an on-site test.

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11 *See, e.g.*, 17 U.S.C. § 119(a)(2)(B)(ii) (providing that, "[i]n determining presumptively whether a person resides in an unserved household under subsection (d)(10)(A), a court shall rely on the Individual Location Longley-Rice model set forth by the Federal Communications Commission in Docket No. 98-201, as that model may be amended by the Commission over time under section 339(c)(3) of the Communications Act of 1934 to increase the accuracy of that model.").

12 A subscriber is eligible to receive digital distant signals if, *inter alia*, after certain conditions are met she is "determined under [47 U.S.C. § 339(a)(2)(D)(vii)] to be unable to receive a digital signal of such local network station that exceeds the signal intensity standard specified in such clause." 47 U.S.C. § 339(a)(2)(D)(i)(III). Section 339(a)(2)(D)(vii), in turn, says that a subscriber shall be eligible for distant digital signals "if such subscriber is determined, based on a test conducted in accordance with section 73.686(d) of [the Commission's rules], or any successor regulation, not to be able to receive a signal that exceeds the signal intensity standard in section 73.622(e)(1) of [the Commission's rules], as in effect on the date of enactment of the Satellite Home Viewer Extension and Reauthorization Act of 2004." 47 U.S.C. § 339(a)(2)(D)(vii). Broadcasters have claimed that this provision prohibits the use of predictive models for determining distant digital signal eligibility. *See also* Comments of the National Association of Broadcasters, FCC Docket No. 05-182, at 3-4 (filed June 17, 2005) ("NAB Comments").

13 *See* NAB Comments at 3-4.

This is not accidental. Testing is a frustrating and costly process for consumers and satellite operators (and, presumably, for local broadcast stations, who must pay for testing when customers qualify for distant network signals).[14] It is, first of all, extraordinarily time consuming for subscribers. In order to seek on-site testing, a subscriber must wait at least thirty days after she has received the results of the predictive model for broadcasters to decide whether to grant waiver(s).[15] Then, she must wait until an independent,[16] qualified tester can be identified in her area. Once DIRECTV places an order for the test, the customer must wait for the tester (not DIRECTV) to arrange the appointment. While DIRECTV often tries to expedite this process, tests must often be delayed because of scheduling issues or bad weather (particularly in the winter months).[17] Moreover, in many areas there are very few independent entities available to conduct such tests -- extending the wait time even longer through no fault of DIRECTV. Thus, even if every subscriber seeking an on-site test ultimately were to receive all channels requested, many would still be unhappy as a result of the delay.

Testing is also frustrating for subscribers. Viewers unfamiliar with section 76.686(d) of Title 47, Code of Federal Regulations, might reasonably think that an on-site test involves somebody looking at their television to determine whether or not they receive an adequate signal. Most are not expecting what actually happens:

- Assuming good weather, the tester raises a "test antenna" to twenty feet above ground level for a single story house (or thirty feet for a two story house), and orients the antenna in the direction of maximum signal strength on each channel.

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14 *See* 47 U.S.C. § 339(a)(4)(B) (allocating cost for on-site testing).

15 47 U.S.C. § 339(c)(4)(A) (providing for testing only "[i]f a subscriber's request for a waiver . . . is rejected and the subscriber submits to the subscriber's satellite carrier a request for a test").

16 *See id.* (requiring selection of "a qualified and independent person" to conduct testing).

17 *See* 47 C.F.R. § 76.686(d)(2)(ii) (instructing testers to "not take measurements in inclement weather or when major weather fronts are moving through the measurement area").

- The tester takes a "cluster measurement" consisting of five readings in four corners of a three-meter square and one reading in the center of the square.
- The tester ranks the cluster measurement results in order to determine the median number.
- The tester adjusts the figures for line loss and antenna factors, and converts them to dBu.
- After the signal test is complete, the tester sends a form back to DIRECTV, which processes the test within several days.

In DIRECTV's experience, those denied the requested distant signals based on such a process end up angry at DIRECTV, at their local broadcast stations, and (for that matter) at their elected representatives.

Even setting aside customer relations, on-site testing is a losing economic proposition. Over the last five years, the average cost of an on-site test has been around $150, although in some areas it can now cost as much as $450. DIRECTV estimates that it would take at least five years to recoup this cost from revenues generated by providing distant signals to those tested eligible for such signals – a time frame unlikely to be realized given churn rates for distant signals.[18]

Analog on-site testing, then, frustrates and inconveniences subscribers and costs money that DIRECTV is unlikely to recoup. Digital on-site testing will be worse on both scores (especially if it becomes the norm) because there are far fewer "independent" entities qualified to conduct on-site tests for digital signals than there are for analog signals and because equipment is in shorter supply. This means that wait times will increase – making viewers even more frustrated than they are now. And it means that

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[18] *See* footnote 5, above (discussing loss of distant signal subscribers in areas where local signals are offered).

costs will increase – making on-site testing an even less attractive economic proposition than it is now.

DIRECTV can think of no reason why federal policy should encourage such a result. It thus urges the Copyright Office to recommend that Congress mandate the development of an accurate and reliable predictive model for digital signals rather than relying on on-site testing. If on-site testing is to continue to be part of the methodology for digital signals at all, it must remain strictly at the satellite operator's option, to be used only in close cases.[19] No less is required if the unserved household limitation is to remain "efficient" as the digital transition progresses.

II. COPYRIGHT OWNERS ARE NOT HARMED BY THE DISTANT SIGNAL STATUTORY LICENSE

The *Notice* also asks a more general question about the distant signal statutory license. At Congress's direction, it asks "the extent to which retransmissions of . . . network stations[20] harm copyright owners of broadcast programming in the United States."[21] DIRECTV takes this to be asking commenters to compare the fees copyright

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[19] *See* 47 U.S.C. § 339(c)(4)(E) ("A satellite carrier may refuse to engage in the testing process. If the carrier does so refuse, a subscriber in a local market in which a satellite carrier does not offer the signals of local broadcast stations under section 338 may, at his or her own expense, authorize a signal intensity test to be performed pursuant to the procedures specified by the Commission in section 73.686(d) of title 47, Code of Federal Regulations, by a tester who is approved by the satellite carrier and by each affected network station, or who has been previously approved by the satellite carrier and by each affected network station but not previously disapproved.").

[20] The *Notice* also asks about superstations. *Notice*, 70 Fed. Reg. at 39345. DIRECTV believes that its analysis with respect to network stations applies equally to superstations. For the reader's convenience, these Comments refer only to network stations.

[21] *Id.* The *Notice* also asks about the "effect, if any, of the section 122 license, which permits royalty-free retransmission of local stations, in ameliorating such harm." *Id.* As DIRECTV believes that the distant signal license does not harm copyright owners of broadcast programming, it does not address this question specifically. It notes, however, that in many cases the owners of copyright in programming viewed under the section 122 license are the same owners of copyright in programming viewed under a same-network station pursuant to the section 119 license.

owners receive under the distant signal statutory license with those they might receive if the statutory license were no longer in force.[22]

As DIRECTV sees it, there is no reason to believe that fees it would pay under the existing statutory license would be materially lower than fees it would pay under any successor system to the statutory license – once, that is, any such system is created and functioning smoothly. In other words, the *best* one could hope for is a return to the *status quo*. Between here and there, though, there would be any number of transaction costs and other market failures to contend with.[23] These would undoubtedly raise the implicit cost of distant signal programming. But one cannot know before the fact whether satellite carriers would actually be willing to absorb such costs (and thus cannot know what effect they would have on copyright owners). Sound public policy, moreover, cannot classify the absence of such transaction costs as "harm" to copyright owners.

A. There Is No Reason To Believe That Copyright Owners Would Receive Less Under Section 119 Than Under A Fully Functional Successor Regime

Section 119's distant signal license essentially provides for royalty rates to be set through negotiation with mandatory arbitration. Specifically, it sets initial rates (which

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[22] *Notice*, 70 Fed. Reg. at 39345 (stating that "'[h]arm' is generally understood to mean the difference in the price that copyright owners would have been able to charge satellite carriers for their programming and the price they actually receive under the fees established for section 119."). DIRECTV believes that this inquiry is meant to address alleged "harm" to the owners of copyright in broadcast programming *retransmitted as distant network signals*, and not alleged "harm" to the owners of copyright in a subscriber's local broadcast stations. The latter type of alleged "harm," DIRECTV, believes, is the subject of the *Notice's* first inquiry, and DIRECTV has addressed it above.

[23] Or, as NAB put it in 1997, there would be a "whole lot of pain and suffering to get there for no particular benefit." *A Review of the Copyright Licensing Regimes Covering Retransmission of Broadcast Signals*, A Report of the Register of Copyrights at 26 (Aug. 1997), *available at* www.copyright.gov/reports ("*1997 Copyright Report*").

have now been superseded).[24] It then provides for a period of negotiations between satellite carriers and copyright owners for rates to replace the interim rates – with the assistance of the Library of Congress in appointing negotiating agents, if so requested.[25] It specifies that the results of such negotiations are binding on the parties thereto, and binding on all satellite carriers and copyright owners if no one objects.[26]

Section 119 also provides for mandatory arbitration to determine the "fair market value" of distant signal programming.[27] This occurs in one of two circumstances: (1) if the parties to voluntary negotiations cannot reach agreement,[28] or (2) if a non-party with standing objects to an agreement that is reached.[29] In the latter case, the results of the arbitration are adjusted to "account for the obligations of the parties under the voluntary agreement."[30]

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[24] 17 U.S.C. § 119(c)(1)(A) (analog); *id.* at § (c)(2)(A). These fees have been superseded by negotiated rates as provide in SHVERA. *See Rate Adjustment for the Satellite Carrier Compulsory License*, Final Rule, 17 Fed. Reg. 17320 (rel. Apr. 6, 2005) (analog rates); *see Rate Adjustment for the Satellite Carrier Compulsory License*, Final Rule, 70 Fed. Reg. 39178 (rel. July 7, 2005) (digital rates).

[25] 17 U.S.C. § 119(c)(1)(B)-(C) (analog); *id.* at (c)(2) (providing that negotiation period for digital signals is the same as that for analog signals). SHVERA provides only one negotiation period (which has occurred), to be used for setting rates to remain in effect until December 1, 2009. 17 U.S.C. § 119(c)(1)(E). DIRECTV assumes for purposes of these Comments that, if the statutory license is retained beyond 2009, it will be amended to provide for negotiations at that point (just as SHVERA's changes to SHVIA reinstituted previous negotiation provisions). *Compare* 17 U.S.C. § 119(c)(1)(B)-(C) *with previous* 17 U.S.C. § 119(c)(2)(B)-(C).

[26] 17 U.S.C. § 119(c)(1)(D). This year, such negotiations included DIRECTV, EchoStar, the Program Suppliers, and the Joint Sports Claimants – representing the majority of royalty payers and recipients.

[27] 17 U.S.C. § 119(c)(1)(F)(ii).

[28] *Id.* at § 119(c)(1)(F)(i)(I).

[29] *Id.* at § 119(c)(1)(F)(i)(II) (providing for arbitration "if an objection to the fees from a voluntary agreement submitted for adoption by the Librarian of Congress to apply to all satellite carriers, distributors, and copyright owners is received under subparagraph (D) from a party with an intent to participate in the arbitration proceeding and a significant interest in the outcome of that proceeding").

[30] *Id.* at § 119(c)(1)(F)(ii). Section 119 appears to provide that arbitrated rates for *digital* distant signals (but not analog distant signals) must be "marked down" by 22.5 percent. *See id.* at § 119(c)(2)(C)(i). This, DIRECTV concedes, raises the theoretical possibility that the presence of

Now suppose the section 119 license were revoked. By far the most likely outcome, it seems to DIRECTV, is that copyright owners would seek to license distant signals through some form of collective bargaining organization.[31] Once such a system were up and running, there would be periodic negotiations between satellite carriers on the one hand and groups representing copyright holders (perhaps even the same groups that negotiated on their behalf earlier this year) on the other. Thus, at least with respect to negotiations, it is hard to see what "harm" befalls copyright holders from section 119.

Section 119 also has a mandatory arbitration provision. But there is no reason to believe, at least before the fact, that the mere existence of arbitration "harms" copyright owners by resulting in materially lower royalty rates. Arbitration is a common and accepted mechanism for resolving commercial issues that presumptively leads to

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arbitration may harm copyright owners with respect to digital signals. DIRECTV believes, however, that the real-world effect of this provision has been, and will be, *de minimus*. To begin with, the satellite operators and copyright owners negotiated a rate agreed to apply to digital programming (which now represents a very small fraction of overall distant signal royalties) before this markdown became law. *See* Letter from Pantelis Michalopoulos *et al.* to David O. Carson, Docket No. 2004-9, March 7, 2005. It is thus impossible to determine whether this markdown had any bearing on the negotiated rates – rates which, by their terms, are not to be regarded as evidence of the fair market value of the copyright programming. *See* Agreement Art. 4. Nor would it be possible at this point to quantify the effect of this markdown in any future negotiation. In any event, however, DIRECTV is inclined to believe that, just as the markdown was eliminated from the provisions governing analog arbitration, it will likewise be eliminated from the provisions governing digital arbitration if and when SHVERA is reauthorized.

31 *See Notice*, 70 Fed. Reg. at 39345. *See also 1997 Copyright Report* at 27. At least two other possibilities exist. First, copyright owners could simply refuse to license distant signals altogether. This, however, would involve leaving a not insignificant amount of money on the table. Second, copyright owners could renegotiate each and every one of their programming contracts with networks and broadcasters to provide not only transmission rights (for broadcasters) but downstream distant signal retransmission rights (for satellite carriers). A variant of this option was discussed by the Copyright Office in 1997, which suggested the possibility of *requiring* broadcasters to obtain such downstream rights, but allowing cable operators to negotiate directly with broadcasters. *See id.* at 24-26. DIRECTV views this latter possibility – changing 50-odd years of programming and syndication contracts in a single stroke – as highly improbable at best. The *1997 Copyright Report* acknowledged that, according to one commenter, "broadcasters have not shown any interest in [such an] arrangement." *Id.* at 25. DIRECTV imagines they would show even less interest in such an arrangement in connection with the satellite distant signal license. In any event, the transaction costs and other market failures described below in Part II.B (with respect to a bargaining arrangement) would undoubtedly apply with even more force to any such attempt to rewrite programming agreements.

equitable results. The arbitration panel is supposed to determine "fair market value" on "economic, competitive, and programming information presented by the parties" including:

- the competitive environment in which such programming is distributed,
- the cost of similar signals in similar private and compulsory license marketplaces,
- any special features and conditions of the retransmission marketplace;
- the economic impact of such fees on copyright owners and satellite carriers; and
- the impact on the continued availability of secondary transmissions to the public.[32]

None of these factors strikes DIRECTV as favoring satellite carriers over copyright owners. Nor is DIRECTV aware of any reason why panels of arbitrators selected pursuant to section 802 would favor satellite carriers over copyright owners. DIRECTV can thus think of no reason to conclude, before the fact, that arbitration would harm one party or another when compared to "bare" negotiation.[33]

In sum, there is no reason to think that copyright holders would receive higher royalty rates under a successor regime to section 119's statutory license. At least, there is no reason to think that would be the case once such a regime is put into place.

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[32] 17 U.S.C. § 119(c)(1)(F)(ii).

[33] To the extent copyright holders take the position that the ability to shut off the signal is an important bargaining tool that would not be available to them under arbitration, the value of that bargaining tool can be explained to, and considered by, an arbitrator.

B. There Are Many Reasons to Expect Market Failures or Transaction Costs If Section 119 Is Revoked

The discussion above assumes that a successor regime to the section 119 statutory license is in place and working perfectly. That is, the copyright owners have created a bargaining group that represents all such owners, and the rules for negotiation have been set and are well understood by all the parties.

For at least forty years, however, observers have recognized the difficulty of arriving at such a well-functioning system in the absence of a statutory license. In 1965, for example, the Register of Copyrights noted:

> A particularly strong point [against finding copyright liability for cable operators' broadcast retransmissions] is the obvious difficulty, under present arrangements, of obtaining advance clearance for all of the copyrighted material contained in a broadcast. This represents a real problem that cannot be brushed under the rug, and it behooves the copyright owners to come forward with practical suggestions for solving it.[34]

Congress described the problem in more detail with respect to the satellite compulsory license:

> The joint activity among satellite carriers, distributors and copyright owners would generally be pro-competitive since the market involving distribution of television signals by satellite to earth station owners is dispersed among millions of households spread throughout this country and also since the legislation is expected to encourage new entrants to participate in the distribution process. Negotiation of individual copyright royalty agreements is neither feasible nor economic. It would be costly and inefficient for copyright holders to attempt to negotiate and enforce agreements with distributors and individual households when the revenues produced by a single earth station are so small.[35]

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[34] 1965 Supplementary Report of the Register of Copyrights at 42-43, *quoted in The Cable and Satellite Carrier Compulsory Licenses: An Overview and Analysis*, A Report of the Register of Copyrights at 8 (March 1992) ("*1992 Copyright Report*").

[35] H.R. Rep. No. 887, 100th Cong., 2d Sess., pt. 1, at 23 (1988). Indeed, the compromise between the broadcasting and cable industries that eventually led to enactment of the cable statutory license – the predecessor to section 119 – has been described as "significant" because "it acknowledge[d] cable liability while at the time recognizing the need of providing a statutory licensing system to

And in 1997, the Copyright Office concluded that

> the cable and satellite licenses have become an integral part of the means of bringing video services to the public, that business arrangements and investments have been made in reliance upon them, that some copyright owners such as NAB, PBS, and NPR favor their continuation, and that, at this time, the parties advocating such elimination have not presented a clear path toward eliminating the licenses.[36]

To put this concept in more economic terms, there is every reason to expect that creating such a system would involve significant market failures and transaction costs.[37] Before discussing specifics, DIRECTV would like to raise a more general point on this topic. Some costs might (eventually) be passed along to satellite carriers in the form of higher royalty rates, but such an increase in royalty rates should not be viewed as a benefit to copyright owners (nor its absence a harm to copyright owners). To begin with, one cannot assume that satellite carriers would be willing to pay such rates, or that consumers would be willing to subscribe to distant signal packages if the price increases are passed along. It is quite likely that such costs would ultimately harm copyright owners, who would lose payments from satellite carriers that they otherwise would have received because of the depressed output.

More fundamentally, the inability to benefit from market failures and to recover transaction costs is not cognizable "harm" to copyright holders. To the contrary, high

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solve problems with transaction costs and the need to assure subscribers access to programming." *1992 Copyright Report* at 15; *see also id.* at 103-04 (describing enactment of section 119 in 1988 as being "intended to balance the rights of copyright owners, by ensuring payment for the use of their property rights, with the interests of satellite dish owners in access to programming, especially in underserved areas").

36 *1997 Copyright Report* at 33.

37 *See Id.* at 139 ("Congress created the cable compulsory license as a means of balancing these interests by creating a system whereby cable operators may retransmit works broadcast by distant television stations without incurring heavy transaction costs involved in getting the consent of each copyright owner whose programming is carried via distant signal.").

costs always result in *social* harm, and public policy does best to avoid them.[38] Thus, as an economic matter, a copyright owner should be deemed harmed only if its *net* royalty rate (*i.e.,* net of the increased transaction costs it bears) would have been higher in the absence of mandatory arbitration.

Market failures and transaction costs can take a number of forms. First is the fact that many copyright owners are affiliated with broadcasters, which transmit their own programming in competition with satellite carriers. As copyright owners, such entities benefit from secondary transmissions, but as competing distributors, they are harmed by secondary transmissions. Often, such entities' interests as distributors overshadow their interests as copyright owners. Thus broadcasters have historically opposed *all* forms of transmission other than over-the-air broadcasting, and to this day remain uncomfortable with the very idea of distant signal retransmission.[39] Particularly in light of broadcasters'

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38 *See* Richard Posner, Economic Analysis of Law 62 (5th Ed. 1998). As Judge Posner describes it, where a purchaser buys a product despite high transaction costs, it must reduce its output correspondingly – meaning they would buy less of the product than they would have otherwise. In the satellite context, this means that satellite subscribers would ultimately purchase less programming than they would otherwise. On the other hand, purchasers could decide to substitute other products because of high transaction costs. In the satellite context, this means that satellite carriers would spend their programming dollars on something other than distant signals. (This, of course, harms both satellite operators *and* the owners of copyright in distant signals). Thus, where there are low transaction costs, "the law should require the parties to transact in the market . . . [while] in settings of high transaction costs people must be allowed to . . . shift resources to a more valuable use, because the market is by definition unable to perform this function in those settings." *Id.*

39 Competition between broadcasters and downstream distributors has been one of the primary subjects of media regulation over the last 40 years. The FCC's very first attempt to assert jurisdiction over cable operators, for example, was in part due to the question of "fair competition" between cable and broadcasting. *See Amendment of Subpart L, Part 91, to Adopt Rules and Regulations to Govern the Grant of Authorizations in the Business Radio Service for Microwave Stations to Relay Television Signals to Community Antenna Systems*, Second Report and Order, 2 FCC 2d 725 (1966). The FCC of that era has been described as "committed to the active support of local broadcasting, particularly by independent stations on the ultra-high frequency bands, and considered it a duty to maintain the inviolability of clearly-defined geographic television markets by preventing cable from fragmenting local audiences and thereby causing a loss of advertising revenue to the local stations." *1992 Copyright Report* at 11.

perceptions that some satellite operators have abused the distant signal license,[40] DIRECTV might be forgiven for thinking that broadcaster-affiliated copyright holders would not be eager to negotiate for distant signal carriage, even if this meant foregoing revenues.

Another obvious and well-recognized problem concerns holdouts. In the absence of section 119's provisions applying negotiated (or arbitrated) rates to all copyright owners, there would be little to prevent individual owners from holding out for higher prices.[41] Holdouts cause at least six distinct problems.

- First, holdouts could be difficult to detect.[42]
- Second, holdouts can often demand prices above those competitive negotiations would produce.[43]
- Third, they cause delay, as each owner of copyright in individual programming maneuvers to be "last in line" in hopes of extracting holdout pricing.[44]

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40 *See Notice*, 70 Fed. Reg. at 39344 (noting that "satellite carriers largely ignored the proscription of the unserved household limitation in the years after 1988"); *Legislative Hearing on HR. ____, Reauthorization of the Satellite Home Viewer Improvement Act, Before the Subcomm. on Telecommunications and the Internet, House Comm. on Energy and Commerce*, 108th Cong. 1 2004) (testimony of Robert G. Lee) (asserting that "one of two DBS companies, EchoStar, has a penchant for ignoring and circumventing statutory provisions relating to the carriage of broadcast signals").

41 *See* Oliver E. Williamson, "Credible Commitments: Using Hostages to Support Exchange," *American Economic Review*, at 73, 519-40 (Sept. 1983); Paul L. Joskow, "Contract Duration and Relationship-Specific Investments: Empirical Evidence from Coal Markets," *American Economic Review*, at 77, 168-85 (March 1987).

42 *See 1997 Copyright Report* at 27 ("Even when a cable system has negotiated with all the major collectives, how can it be assured that it has cleared all rights? What if there were an individual copyright owner who was not represented by any collective, and he or she decided to sue when his or her work was retransmitted?").

43 For a basic discussion of this principle, *see* Economic Analysis of Law at 62 (discussing holdouts in the context of eminent domain, and noting that, "knowing [that a company has begun construction on a railroad], people owning land in the path of the advancing line will be tempted to hold out for a very high price – a price in excess of the opportunity cost of the land").

44 *See id.* at 69 (discussing holdouts in the context of a polluting factory and 1,000 homeowners, and noting that "because the holdout can extract an exorbitant price . . . each homeowner has an incentive to delay coming to terms with the factory in hope of being the holdout").

- Fourth, their presence would geometrically increase negotiation costs, as satellite carriers would replace a single negotiation (under today's system) with (presumably) dozens of negotiations.

- Fifth, their presence would dramatically increase litigation costs, as each individual copyright holder could sue a satellite carrier for infringement.[45]

- Sixth, because holdouts represent *individual programs*, not channels to be retransmitted, satellite carriers would have to black out individual programs if agreement could not be reached – causing costs both to the satellite carrier (in monitoring and implementing such blackouts) and to the viewer (who would have paid for distant signals but could not watch all of the programming on the channel).[46]

A third set of issues relates to the costs of putting together a bargaining collective itself. Those costs remain uncertain, particularly because there now exist groups that have formed for the purposes of negotiating for *distribution* (*e.g.*, Joint Sports Claimants, Program Suppliers), but which also have taken a role in *royalty rate* negotiations. On the other hand, at least some commenters have suggested that, in the absence of a statutory license, the activities of such groups might raise antitrust concerns (or, at least, that they would require costly antitrust oversight).[47]

A fourth set of issues relates to knowledge. As the Copyright Office acknowledged in 1997, "[w]hen a cable system [or satellite carrier] retransmits a broadcast signal it cannot know in advance every copyrighted work that will be on it . . . ."[48] The Copyright Office then asked, "how can it negotiate ahead of time?" – a question to which DIRECTV does not have an answer.

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45 *See 1997 Copyright Report* at 27.

46 *See id.* at 28 (discussing problems associated with blacked out signals).

47 *See id.* at 26 (quoting the Association of Local Television Stations as referring to such groups as "antitrust time bombs").

48 *Id.* at 27.

Finally, any shutdown attributable to failure to reach agreement with copyright owners generates social costs. In particular, the marginal cost of supplying distant programming to an additional subscriber is zero (or very small), while the benefit to consumers receiving such signals is positive. Thus, a shutdown in programming entails a loss of social surplus equal to the difference between the clear benefit consumers would have received from that programming and the negligible costs of providing it.

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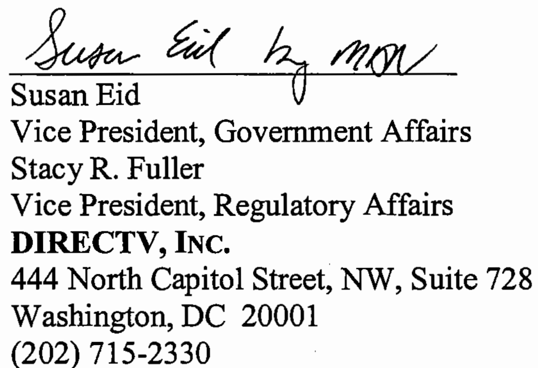
For the foregoing reasons, DIRECTV submits that (1) satellite operators should be able to continue using a predictive model to identify "unserved" households, and (2) copyright owners are not harmed by the distant signal statutory license of section 119.

Respectfully submitted,



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