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Definition of Cable System) Docket No. 2007-11

COMMENTS OF THE

cable

NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

Gregory L. Klein
Vice President, Research

Daniel L. Brenner
Diane B. Burstein
Counsel for the National Cable &
Telecommunications Association
25 Massachusetts Avenue, N.W. – Suite 100
Washington, D.C. 20001-1431
(202) 222-2445

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The National Cable & Telecommunications Association ("NCTA"), by its attorneys, hereby submits its comments in response to the Copyright Office's Notice of Inquiry ("*Notice*") in the above-captioned proceeding. NCTA is the principal trade association of the cable television industry in the United States, representing owners and operators of cable systems serving more than 90 percent of the nation's cable customers. NCTA's members also include hundreds of cable program networks.

INTRODUCTION

The Copyright Office initiated this Inquiry in response to NCTA's 2005 Petition for Rulemaking to resolve the "phantom signal" problem.[1] A "phantom signal" is a distant broadcast signal, not uniformly carried throughout commonly-owned, contiguous cable systems, whose carriage is artificially attributed for royalty calculation purposes to communities where the signal is not being retransmitted to subscribers. This artificial attribution of carriage results in an inflated fee payment when cable systems carrying different complements of distant broadcast signals to different communities file a single statement of account covering such communities.

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[1] *Petition for Rulemaking of the National Cable & Telecommunications Association on Resolving the "Phantom Signal" Issue* (filed Aug. 17, 2005) (hereinafter "NCTA Petition").

This is now the third time the Office has issued a *Notice of Inquiry* on the question of how to rationalize the calculation of royalties in these circumstances. NCTA's 2005 Petition recounted in detail this proceeding's lengthy history.[2] NCTA first asked the Office to modify its definition of a "cable system" in 1983 as one way to help address this issue and to ensure that only technically integrated systems were required to file as a unitary cable system. That Petition lingered for three years until the Office issued a *Notice* that raised related questions.[3] Three years later, the Office released another *Notice of Inquiry* in the context of merged systems and sought comments on NCTA's 1983 Petition.[4] The Office later asked for more comments in that same docket on à la carte offerings of broadcast signals.[5] But after gathering comments for more than a decade, in 1997 the Office chose not to resolve the issue but rather to terminate the phantom signals proceeding.[6] Thus, NCTA has never obtained resolution of this issue, nor has the Office ever issued an appealable order.

This *Notice of Inquiry* – nearly twenty-five years after the cable industry first brought this question to the Office's attention, and nineteen years after the Office sought comment on NCTA's first Petition on this issue – is ripe for decision. There is no statutory impediment to the Office ending the phantom signal problem. Requiring a cable operator to pay royalties for retransmitting copyrighted works into a community when, in fact, those works are not actually being so retransmitted and thus are not being seen by the operator's customers, makes no sense as a matter of law, policy, or basic fairness. And the delay in considering this matter adds a

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2 NCTA Petition at 4-8. *See also Notice* at 70531.

3 "Definition of a Cable System," *Notice of Inquiry*, Docket No. 86-7, 51 Fed. Reg. 36705 (Oct. 15, 1986).

4 *Compulsory License For and Merger of Cable Systems, Notice of Inquiry*, Docket No. RM 89-2, 54 Fed. Reg. 38390 (Sept. 18, 1989).

5 *Extension of Comment Period*, Docket No, RM 89-2A, 60 Fed. Reg. 2365 (Jan. 9, 1995).

6 *Final Rule and Termination of Proceeding*, Docket Nos. RM 89-2, RM 89-2A, 62 Fed. Reg. 23360 (Apr. 30, 1997).

degree of injustice unprecedented in the cable copyright context. We respectfully urge the Office to quickly issue a proposed rulemaking to avoid perpetuating an irrational policy that can result in an unjustified windfall to copyright owners and imposes unjust costs on cable operators and their customers.

DISCUSSION

A. "Phantom Signals" Can Arise under Several Scenarios

Section 111 of the Copyright Act provides that two or more cable systems are to be considered as one cable system whenever the systems are "in contiguous communities under common ownership or control or operating from one headend."[7] Copyright Office regulations implementing this definition largely repeat this statutory language, although the regulations break the text into two parts.[8] A problem with calculating royalties can arise when this definition forces two or more systems that carry different complements of distant signals to file a single Form 3 Statement of Account.

The *Notice* appears to assume that this "phantom signal" problem is confined to limited circumstances – where System A and System B, each carrying a unique set of distant signals, merge and are not yet technically integrated.[9] In this scenario, the *Notice* explains, "phantom signals may arise because the systems are not yet technically integrated and thus an operator is incapable of transmitting the distant signals to all subscribers it serves after a merger. That is, the distant signals cannot be made available to certain subscriber groups."[10] The Office suggests that the phantom signal issue is temporary in such a situation: "if over time, the cable systems

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7 17 U.S.C. § 111(f) (definition of a "cable system").

8 37 C.F.R. § 201.17(b)(definition of a "cable system") ("For these purposes, two or more cable facilities are considered as one individual cable system if the facilities are either: (i) In contiguous communities under common ownership or control or (ii) Operating from one headend.").

9 *Notice* at 70530.

10 *Id.*

become technically integrated, and the signals are apparently available to all subscribers, then the phantom signal problem would disappear."[11]

That is certainly one scenario in which it could arise. But the Office's phantom signal policy has the potential to force an operator serving multiple communities from a single "system" (as defined by the Office's rules) to calculate its royalties as if it provides a single line-up of distant signals to each of the communities, even though subscribers in different communities have access to different signals.

It is not necessarily the case that all systems in which phantom signals might arise can or will eventually become technically integrated with identical line-ups system-wide. Phantom signals can occur when cable operators pursue a regional strategy of clustering systems in relatively close proximity to each other.[12] Even where neighboring systems come under common ownership, an operator may continue to operate them from separate facilities where doing so makes sense from a business or operational standpoint. Phantom signals also can arise where commonly-owned System A and System B become contiguous with each other through system expansion. Not only do the Office's rules require the operator to artificially "merge" these systems through filing a single statement of account even where there are valid and rational grounds for maintaining separate headends; the phantom signal policy could also force an operator to report and pay royalties as if it provides a single distant signal line-up, even though customers in System B do not receive the same signals as those in System A. In short, the phantom signal policy can require operators to artificially inflate their royalty payments whenever an operator serves multiple communities with different line-ups, whether the signals originate from one technically integrated facility or separate headends.

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11 *Id.*

12 *NCTA Petition* at 8-9 (discussing cable system clustering).

As the *Notice* suggests,[13] technical reasons may account for some differences in channel line-ups for systems in some situations. But technical reasons may not be the only reasons. For example, customers of two different systems may have different settled viewing expectations based on historical distant signal carriage – viewing expectations that operators are loath to upset. Operators may not be able to create a unified line-up by adding a distant signal, either. The scarcity of available channels on a basic tier makes it difficult to achieve uniformity through increasing the number of distant broadcast stations throughout each community served by the same operator.

The *Notice* does not explain why any relief should be limited to "those situations where two or more systems have recently merged."[14] Nor does it offer any reason why customers otherwise should be penalized in the form of higher royalties "where a cable operator provides a different set of distant signals to different subscriber groups served by the same cable system."[15] Relief from phantom signal calculations should extend in all such circumstances.

B. A Statutory Change is Unnecessary to Fix the Phantom Signal Issue

1. The Copyright Office Can Protect Against Artificial Fragmentation of Systems

As described above, the Copyright Act defines when two separate cable systems must file as a single system. But Congress had a simple purpose in mind in adopting its "cable system" definition: to prevent a single cable system from being artificially separated into multiple systems in order to reduce the amount of royalty fees owed.[16] As the Office explained in its

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[13] *Notice* at 70531 (asking whether there are any "technical obstacles to providing all distant broadcast signals carried by a cable system to all subscribers served by that cable system").

[14] *Id.*

[15] *Id.*

[16] *See 1983 NCTA Petition for Issuance of Notice of Proposed Rulemaking* at 4-5 (filed Aug. 22, 1983) (explaining legislative history of "cable system" definition).

1997 Report recommending a congressional fix to the phantom signal problem, "so long as there is a subsidy in the rates for the smaller cable systems, there will be an incentive for cable systems to structure themselves to qualify as a small system."[17] Congress was concerned that a unitary cable system might find it less costly to file as two Form 1 or Form 2 systems than as a single Form 3 system.

The Office in the *Notice* expresses concern that it cannot change the "cable system" definition from that which appears in the Copyright Act. The Office, though, can protect against artificial fragmentation and can remain true to the "cable system" definition without requiring irrational fee calculations. NCTA has already proposed one way to address any legitimate concerns in this area. Under its proposal, cable operators would continue to combine revenues from separate – but commonly-owned and contiguous – cable systems to determine their filing status as a Form 1, 2 or 3 system. NCTA's proposed rule would require "a cable system serving multiple communities [to] use the system's *total gross receipts* from the basic service of providing secondary transmission of primary broadcast transmitters to determine which of the Statement of Account Forms … is applicable to the system…."[18] Thus, the concern underlying the Copyright Act definition is squarely addressed by NCTA's proposal.[19]

This definitional issue need not and should not get in the way of resolving the phantom signal problem. The statutory definition of a "cable system" is not the underlying reason for

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17 U.S. Copyright Office, "A Review of the Copyright Licensing Regimes Covering Retransmission of Broadcast Signals," A Report of the Register of Copyrights (Aug. 1, 1997) (hereinafter "1997 Copyright Office Report") at 45.

18 Letter from Daniel L. Brenner, Senior Vice President, Law & Regulatory Policy, NCTA, to Tanya M. Sandros, Associate General Counsel, U.S. Copyright Office (filed October 10, 2006) at Appendix A ("NCTA Letter") (emphasis supplied).

19 The *Notice* explains that "the regulatory definition of the term 'cable system' is virtually identical to the definition found in Section 111(f) of the Copyright Act. As such, we do not believe that we have the authority to adopt a regulatory definition that fundamentally alters the statute, even thought the language of Section 111 may be one of the root causes of the phantom signal problem." *Notice* at 70532. But the Office can adopt NCTA's proposal without doing violence to the language of the Act or Congressional intent.

phantom signals. Copyright Office policy, rather than statutory language, causes royalty calculations to be made on this basis. Congress evinced no intent to artificially inflate the number of distant signal equivalents that must be assessed against a combined gross receipts base resulting from a single merged "cable system."

2. NCTA's Community-Based Royalty Calculation Is Consistent with the Copyright Act

NCTA's proposed solution to the phantom signal problem ties royalty payments to the distant signals received in a particular cable community. This proposal fairly compensates copyright owners without imposing an irrational payment scheme on cable operators and their customers. Such a regulation would simply clarify the Office's administrative policy and in no way would require a statutory amendment to Section 111.

NCTA proposed that "where the complement of distant stations actually available for viewing by subscribers to a cable system is not identical in all of the communities serviced, the royalties due for the system may be computed on a community-by-community basis by multiplying the total distant signal equivalents derived from signals actually available for viewing by subscribers in a community by the gross receipts from secondary transmission from subscribers in that community."[20] Program Suppliers supported a very similar method for calculating royalties, reading the Act to permit a community specific payment plan. Their comments, submitted in response to an earlier *Notice* on this subject, explained that "the statutory language and intent require that in all cases of a commonly owned contiguous communities cable system, the system must use the combined gross receipts from the entire system to determine the proper royalty system classification (*i.e.*, Form 1, 2, or 3) and must file a

[20] NCTA Letter at Appendix A. This proposal is virtually identical in concept to NCTA's 1989 proposal. *See* Comments of the National Cable Television Association at 8-15 (filed Dec. 1, 1989) (discussing community-specific approach).

single SOA [Statement of Account] for the entire system. Having met these statutorily-prescribed conditions, Program Suppliers submit that *where signal carriage complements differ among facilities within a merged system, reporting and payment requirements can be tailored to recognize these differences*."[21] The Copyright Office itself recommended adoption of subscriber groups as the solution to this problem in its 1997 Report.[22]

Section 111 contains no legal impediment to the Office immediately resolving the phantom signal problem in a way that the Office itself, the Program Suppliers, and the cable industry have long advocated. Nowhere does Section 111 expressly mandate phantom signal treatment. Nowhere in the statute or its legislative history is there any suggestion that Congress deliberately crafted Section 111 (and the associated definitions of "cable system" and "distant signal equivalent") to create the phantom signal problem. The most that can be said is Congress did not directly lay out the subscriber group mechanism to resolve phantom signal situations, as it did where a single signal is carried on a partially-local/partially-distant basis.

The Copyright Office undoubtedly can adopt a community-by-community tailoring of its regulations. As a general matter, the Office has the power to administer the Copyright Act. As the D.C. Circuit found, "Congress recognizes that it can only legislate, not administer, so it necessarily relies on agency action to make 'common sense' responses to problems that arise during implementation, so long as those responses are not inconsistent with congressional intent."[23] The Office itself has stated that it has the authority "to develop forms, practices and

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[21] Comments of Program Suppliers, Docket No. RM- 8902 (filed Dec. 1, 1989) at 4 (emphasis supplied).

[22] 1997 Copyright Office Report at 46 (recommending Congress amend Section 111 to provide that "once two or more cable systems have been deemed a single larger cable system, the calculation of the rates shall be based on those subscriber groups who receive the secondary transmission as the Register of Copyrights shall by regulation provide").

[23] *Cablevision Systems Development Co v. Motion Picture Association of America*, 836 F.2d 599, 612 (D.C. Cir.), cert. denied, 487 U.S. 1235 (1988).

policies."[24] In issuing its *Notice of Inquiry* in 1989 on this matter in the context of merged systems, the Office explained its "preliminary assessment" that "the issues posed by merger and acquisition of systems are *primarily matters of administrative and regulatory policy.* To the extent that neither the statute nor the legislative history of the Act gives guidance, the Copyright Office could probably provide guidance based on *its responsibility for the fair and effective administration of the compulsory license.*"[25] Thus, the Office has an obligation to construe the statute in a sensible and logical fashion.

Moreover, the Office can use that authority to adopt NCTA's proposed solution. Creating subscriber groups for royalty fee purposes is not only a fair method for resolving this problem, it is a method the Office *itself* has embraced. Hardly a novel solution, the Copyright Office authorizes operators to create subscriber groups to calculate royalties for "partially-permitted, partially non-permitted" distant signals.[26] The Office took that practical step even though the Act was similarly silent as to its ability to create subscriber groups in that context. Thus, past practice confirms that nothing in the Copyright Act prohibits the creation of subscriber groups or requires that operators calculate royalties based on fictitious notions of system-wide carriage. Existing Copyright Office regulations provide that subscriber groups should be created so that each broadcast signal carried on a cable system can be properly designated with respect to that particular subscriber group, as a non-permitted distant signal, a permitted distant signal, or a local signal. If Section 111 is to be sensibly applied, a fourth designation for that broadcast signal (*i.e.*, "not carried") is essential.

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24 *Compulsory License for Cable Systems*, 49 Fed. Reg. 13029, 13031 (Apr. 2, 1984).

25 *Compulsory License for and Merger of Cable Systems*; *Notice of Inquiry*, 54 Fed. Reg. 38390, 38392 (Sept. 18, 1989) (emphasis supplied).

26 *Cable Compulsory License: Merger of Cable Systems and Individual Pricing of Broadcast Signals*, 62 Fed. Reg. 23360 (Apr. 30, 1997).

In fact, calculating royalties based on actual carriage is entirely consistent with the Act's structure. The Act's requirement that operators pay a minimum fee, regardless of whether any distant signals are carried at all, is a narrow exception to this general principle. And the legislative history explains this minimum payment for the privilege of retransmitting distant signals served a particular purpose: "the purpose of this initial rate, applicable to all cable systems in this class, is to establish a basic payment, whether or not a particular cable system elects to transmit distant non-network programming."[27] Beyond this basic payment required of all operators retransmitting broadcast signals, the Act and its legislative history show no intent to inflate the amount of other payments through some artificial levy for non-use. To the contrary, as NCTA's Petition points out, the Act is predicated on actual carriage of actual signals, and the treatment of carriage of those signals in a particular community under the FCC's regulations.[28]

Therefore, NCTA's proposed regulation closely hews to the statutory scheme. It ensures against any attempt to artificially reduce the amount of royalties owed through unfairly taking advantage of the lower royalties paid by Form 1 and 2 systems. But it protects against operators and their customers being forced to provide copyright owners with an entirely unintended windfall.

C. Application of NCTA's Proposal

Against this backdrop, the *Notice's* single-minded focus on the size of the royalty pool in assessing the potential impact of fixing the phantom signal problem seems more than passing strange. To the extent the policy artificially increases royalties paid, copyright owners should not be receiving a bonanza based on non-performance of their works in the first place. Cable

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[27] H. R. Rep. No. 94-1476, 94th Cong. 2d Sess. 96 (1976).

[28] *See* NCTA Petition at 13-15 (*citing* Joint Comments of Cable Operators in Docket No. RM 89-2 (filed Dec. 2, 1989)).

operators and their customers should not be forced to pay for copyrighted works they do not – and cannot – use. Ironically, in some situations the policy leads to a reduction in royalty fees, since operators are effectively encouraged to drop distant broadcast signal entirely, rather than pay for phantom carriage.

The *Notice* contains several hypotheticals designed to compare royalties calculated under NCTA's proposal and under the phantom signals regime.[29] Set 1 shows various scenarios involving the calculation of royalties where a Form 1/2 system is combined with a Form 3 system. Under Scenario 1, the combined royalty for two "unmerged" systems – a Form 3 system with 2 permitted and one non-permitted distant signals (System 1) and a Form 2 system with no distant signals (System 2) is $31,801.50 – $29,870.50 for System 1 and $1931.00 for System 2. If these two systems are forced to "merge" for purposes of the compulsory license, but continue to have separate line-ups, the combined royalty payment under the Office's phantom signal approach increases by $15,719.75 (from $31,801.50 to $47, 521.25).[30] Put another way, the mere fact that these two systems are combined for filing purposes results in a 900 percent increase in the copyright costs for subscribers to System 2 (from $1931.00 to $17,650.75). In contrast, under the approach proposed by NCTA, the combined royalty for the two systems would still increase (as a result of the application of the Form 3 rates to System 2's revenues), from $31,801.50 to $33,162.75 (representing a 70 percent increase in the cost to System 2 subscribers).

Sets 2 and 3 illustrate two additional scenarios, both arising from the merger of two Form 3 systems. In Set 2, NCTA's proposal to use subscriber groups would mean that cable royalties

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[29] *Notice* at 70534.

[30] *See* Scenario 2. Although the description of Scenario 2 indicates that all subscribers to the two systems represented therein are receiving the same signals, the result would be the same under the Office's policy even if the subscribers to System 2 were receiving no distant signals, the situation implied by Scenario 1.

would not increase for either system when the merger occurred. And that is how it should be; since both systems already are paying rates at the Form 3 level, there obviously can be no realistic concern with artificial fragmentation of the system in order to reduce royalty fees. By contrast, the phantom signal approach would cause fees to increase by $89,848 based on the fiction that customers in System 1 and System 2 received six distant signals each, when in fact no customer receives more than three such signals. Nothing in the Copyright Act or its legislative history compels this unfair result.

Similarly, Set 3 illustrates the difference when two separate Form 3 systems merge, with a system carrying one partially-distant signal in only one system. Again, the Office's hypothetical demonstrates that, under NCTA's proposal, the total royalty payments due before and after the merger of the systems would remain exactly the same where the signal line-ups available to the communities served by the system are the same both before and after the merger.[31] In contrast, under the Office's approach, the royalty due would increase by over 55 percent – from $41,401 to $64,447. Only an Alice in Wonderland "through the looking glass" perspective could lead one to conclude that NCTA's proposal results in a "reduction" in an operator's royalty payments. Rather, NCTA's proposal merely prevents the large, and unjustified, increases in royalty payments that can be produced by the irrational phantom signal policy.

Several of the Office's other hypotheticals highlight anomalous situations unlikely to arise in the real world. For example, the *Notice* seeks comment on application of the syndicated

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[31] The Office's calculation of the amount due under NCTA's approach (Scenario 3) miscalculates that amount as $35,829.50, thereby suggesting a reduction in the royalties due. However, the Office has mistakenly failed to compute the minimum fee due from subscribers in Group I ($5571.50). When that amount is added to the amounts calculated for Groups II and III, the total due is $41,401 – the same total royalty due pre-merger (Scenario 1).

exclusivity surcharge to subscriber groups.[32] Only seven systems paid syndex surcharge royalties last accounting period, and the amount paid ($25,000) is *de minimis* when compared to the total semi-annual royalty payments of more than $70 million.[33] Similarly, the *Notice* suggests that there could be scenarios where a Form 1 system merging with a Form 3 system might pay less than the $52 minimum fee if it carries no distant signals and has gross revenues less than $5,133.[34] Concerns about these relatively farfetched scenarios, though, do not justify inaction here. Anomalous situations might occasionally arise if subscriber groups are used for calculating royalties; the Office could tweak NCTA's proposed regulations to address these issues. But these unusual situations do not provide a legitimate reason to avoid remedying this situation altogether. Surely the Copyright Office does not believe that these rare and minor anomalies justify retaining the far more egregious anomaly presented by the phantom signal problem.

D. Application of the 3.75% Rate

The *Notice* posits several other questions about how to apply the 3.75% rate in cases of phantom signals. There would be no rationale for applying the 3.75% penalty rate simply because two systems merged. Indeed, the *Notice* sets forth in detail the history of the Office's determination to allow cable operators to create subscriber groups so that the 3.75% rate is not paid in communities in which carriage of a particular signal would have been permitted. It would be strange indeed if the Office were to rule that signals that are *not even carried at all* in these communities must pay at the 3.75% penalty rate.

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[32] *Id.*

[33] CableData Corp. data for accounting period 2006 – 2 (as of Dec. 14, 2007).

[34] *Notice* at 70534. The *Notice* maintains that there are about 500 cable systems with gross revenues less than $5133 that filed during the first accounting period of 2006. That statistic, however, does not reveal how many of those Form 1 systems in fact are carrying multiple distant signals, which would affect the calculation of royalties for a combined system.

Under Section 801 of the Copyright Act, the royalty adjustment was intended to address "*carriage* by cable systems of additional television broadcast signals beyond the local service area of the primary transmitters of such signals..."[35] As the D.C. Circuit explained it, the 3.75% penalty rate was to apply only to "*newly added signals*, i.e., those *carried* for the first time after change in the FCC's distant signal rules."[36] There is no conceivable policy reason for requiring payment at all for distant signals that are not carried in a particular community, where copyrighted material on that station is not even seen by an audience in that area. Forcing operators and their customers to pay the 3.75% rate for phantom signals compounds the absurdity of this scheme. Imposing the 3.75% rate on a signal not carried in a particular community would be completely unmoored from any justification for the penalty rate in the first place. [37]

E. Forms 1 and 2 Cable System Issues

Finally, the *Notice* asks about the effect of NCTA's subscriber group proposal on smaller cable systems that use Forms 1 and 2 and that would still fall below the Form 3 threshold following a "merger" of the systems.[38] Because only larger (Form 3) systems pay royalties based on the number of distant signals carried, the Office is correct that smaller system payments will not be affected in this situation.

CONCLUSION

Cable operators have no objection to paying copyright owners for the retransmission of copyrighted material carried on distant television stations that are carried on a cable system. But

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[35] 17 U.S.C. § 801(b)(2)(B).

[36] *National Cable Television Association, Inc. v. Copyright Royalty Tribunal*, 724 F. 2d 176, 180 (D. C. Cir. 1983).

[37] In any event, as the *Notice* suggests this issue would be moot if the Office were to adopt NCTA's subscriber group approach. *Notice* at 70536.

[38] *Id.*

copyright owners should not be entitled to be compensated from cable operators and, ultimately, their customers, where no such performance occurs in a particular community. NCTA urges the Office to quickly address its irrational policy to prevent this unjustified windfall.

Respectfully submitted,

Gregory L. Klein
Vice President, Research

Daniel L. Brenner
Diane B. Burstein
Counsel for the National Cable &
Telecommunications Association
25 Massachusetts Avenue, N.W. – Suite 100
Washington, D.C. 20001-1431
(202) 222-2445

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