Before the
COPYRIGHT OFFICE
LIBRARY OF CONGRESS
Washington, D.C. 20024

In the Matter of	)	
	)	
Verification of Statements of Account	)	Docket No. 2012-5
Submitted by Cable Operators and	)	
Satellite Carriers	)	

REPLY COMMENTS OF THE COPYRIGHT OWNERS

The Joint Sports Claimants, Program Suppliers, Music Claimants, Public Television Claimants, Canadian Claimants Group, National Public Radio, and Devotional Claimants (collectively "Copyright Owners") submit their reply comments in response to the Copyright Office's Notice of Proposed Rulemaking ("NPRM"), Verification of Statements of Account Submitted by Cable Operators and Satellite Carriers, 78 Fed. Reg. 27,137, 27,138 (May 9, 2013). The NPRM contains the Office's revised audit procedure rules proposal ("Revised Proposal"), a proposal that largely adopts the proposed regulations ("Joint Proposal") of the Copyright Owners, NNCTA, and DirecTV, two major user stakeholders, (collectively "Joint Stakeholders"), for implementing 17 U.S.C. §§ 111(d)(6) and 119(b)(2), enacted as part of the Satellite Television Extension and Localism Act of 2010. Comments regarding the revised proposal were filed by American Cable Association ("ACA") and by AT&T Inc. ("AT&T").

Copyright Owners continue to support the Joint Proposal, but they now reply to the unfounded objections raised by AT&T and ACA. Included among those objections is ACA's attempt to take advantage of the Office's misinterpretation of the cost-splitting provision in the Joint Proposal. The Office's proposed revision of the cost-splitting provision undermines the purpose of that provision, and ACA's attempt to use that misunderstanding to create a loophole for cable operators should be rejected. Copyright Owners also explain why "there is [] benefit in requiring licensees to provide" a certified list identifying the classification of each signal on a community by community basis" when, according to the Office, that information "should be apparent from the face of their Statements of Account." NPRM at 27,141.

A. Neither AT&T Nor ACA Have Justified Their Claims Regarding the Revised Proposal's Cost-Shifting and Cost-Splitting Provisions

AT&T, without even acknowledging the thorough refutation of its legal position on cost shifting, NPRM at 27,147-48, much less providing any rebuttal to that point-by-point rejection, merely "incorporates its prior comments by reference" as purported justification for its continued belief that "its position is correct." AT&T Comments at 2. Lacking any new or added support, AT&T's legal position remains as invalid now as when it was originally submitted.

AT&T contends the addition of the audit right provisions does not undercut the premise that "copyright owners ultimately [must seek] recourse through the courts if they believe that the licensee has failed to fulfill its obligations under the statute and the rules," and therefore the owners must institute a legal proceeding to determine "whether the cost shifting thresholds have been met." AT&T Comments at 2. But the audit right provisions do alter that premise by offering licensees an alternative means for fulfilling their statutory and regulatory obligations, namely, that "if the auditor discovers an underpayment on a Statement of Account, a licensee 'may' cure that underpayment by submitting additional royalty payments." NPRM at 27,149. This option, if chosen, would moot the need to seek a remedy for underpayment through infringement litigation

In any event, AT&T's latest attempt to have courts resolve cost shifting threshold questions is nothing more than a variation of its earlier assertion that "the licensee should not be required to pay for the cost of the audit unless a court determines that the licensee failed" to comply. *Id.*; *see* AT&T Comments at 3 ("AT&T again urges" the Office to adopt this approach). The Office's reasoning provides ample grounds to reject both variants: "the Revised Proposal strikes a more appropriate balance between the interests of the participating copyright owners and the statutory licensee" by requiring the disagreeing party to take legal action. NPRM at 27,149. Conversely, if both parties agree with the auditor's assessment then the curing supplemental payment and the cost shifting issues are resolved without resort to court action.

Indeed, in the Joint Proposal, Copyright Owners made significant concessions to statutory licensees on the issue of cost-shifting. First, although the Office originally proposed a 5 percent threshold for cost-shifting, *see* Verification of Statements of Account Submitted by Cable Operators and Satellite Carriers, 77 Fed. Reg. 35,643 (June 14, 2012), a threshold that Copyright Owners endorsed and which has been used in other audit provisions, *see* Comments of Copyright Owners at 9-10, Copyright Owners subsequently agreed to accept a higher threshold of 10 percent. Second, notwithstanding an auditor's finding that a statutory licensee's underpayment was greater than 10 percent, Copyright Owners agreed that if a statutory licensee submits a good faith objection to the auditor's findings, the costs of the audit would be split between copyright owners and the licensee (pending a judicial finding favoring either party, which would allow that party to recoup its costs). If anything, the Office's Revised Proposal has unnecessarily complicated the operation of this provision by modifying it so cost-splitting will take place only in cases where the statutory licensee's explanation indicates that the underpayment was between 5 and 10 percent. *See* NPRM at 27,152 (proposed § 201.16(j)(1)).

The Office and ACA claim that this modification is necessary because the Joint Proposal "would require the licensee to pay for half the costs of the audit if the auditor discovered a net aggregate underpayment of 10 percent or less--even if the underpayment was as low as .001 percent of the amount reported on the Statements of Account." *Id.* at 27,148; *see* ACA Comments at 3 ("[S]plitting audit costs if the auditor finds a net aggregate underpayment of less than five percent may impose an unfair burden on small cable operators."). This claim incorrectly characterizes the operation of the Joint Proposal, which does not require cost-splitting where the *auditor* concludes that the underpayment was less than 5 percent. The Joint Proposal does not call for *cost-shifting* unless "the auditor concludes that there was a net aggregate underpayment of more than ten (10) percent." Joint Proposal at 8. Thus, the situation posited by the Office and ACA would not trigger any cost-shifting.

Rather, the Joint Proposal limits *cost-splitting* to situations where two conditions are met: (1) the auditor concludes that there was a net aggregate underpayment of more than ten (10) percent but (2) the *statutory licensee* submits a good faith objection disputing that conclusion. *Id.* at 8-9. The fact that a licensee may claim that the underpayment was .001 percent does not, by itself, alter the auditor's finding that the underpayment exceeds 10 percent, and by modifying the Joint Proposal to limit cost-splitting to situations where the licensee claims that the underpayment was between five and ten percent, the Office has wrongly conflated the licensee's position on the amount of the underpayment with the auditor's findings. In the Joint Proposal, Copyright Owners, NCTA, and DirecTV agreed that where such disputes arise, the costs of the audit shall be split between the parties, subject to later adjustment depending on which party prevails at court on the size of the underpayment.[1]

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[1] Under the Joint Proposal, ultimately after litigation, the licensee would bear either all the costs of the audit if a court upholds the auditor's view that underpayment exceeds 10 percent, or none of the costs if the court upholds the licensee's view that the underpayment was less than 10 percent.

Copyright Owners made a significant concession by agreeing to the Joint Proposal's cost-splitting provision, and the Office should not undermine that concession by restricting the cost-splitting provision in the fashion suggested by the NPRM's modification.[2]

AT&T's claim that it "would be both an unwieldy and potentially costly process" for a licensee to recover unwarranted auditor costs from multiple copyright owners (AT&T Comments 2-3) is unrealistic. As in this proceeding and virtually every other cable royalty matter, owner claimant groups would be the most probable participants in audits, and would be fully identified prior to commencement of the audit. In such circumstances, the owners would almost certainly request a single payment from a licensee for audit costs that would then be divided internally by the groups. Likewise, in the unlikely event that a licensee successfully recovered those audit costs, repayment would most likely involve a single payment on behalf of all involved groups. Further, the owner groups have remained stable for decades; that stability plus the fact that the owner groups would likely be subject to a court order requiring them to reimburse a successful licensee. In short, the licensee will have no trouble identifying and finding the relevant copyright owners in the event it is eligible to recoup the costs of the audit.

[2] Read literally, the Office's provision would require cost-shifting, rather than cost-splitting, in cases where the statutory licensee claims that the underpayment was 5 percent or less. ACA asked the Office to clarify this provision so that no cost-splitting of any kind would be required where the licensee claims that the underpayment was less than 5 percent. Comments of ACA at 4 & n.11. The Office should reject ACA's position, which would allow a statutory licensee to avoid sharing in the costs of an audit merely by claiming that the underpayment was 5 percent or less. The Office should instead restore the original intent of the Joint Proposal, which called for cost-splitting only if two conditions are met: (1) the auditor concludes that the underpayment was greater than 10 percent but (2) the statutory licensee submits a good faith explanation disputing that conclusion. Any alleged unfair burden of this cost-splitting on small cable operators has been negated by proposed § 201.16(j)(3), which provides "No portion of the auditor's costs that exceed the amount of the net aggregate underpayment may be recovered from the statutory licensee," and which applies to cost-splitting as well as to cost-shifting.

B. Audits Should Be Governed By Generally Accepted Accounting Principles

AT&T "again submits that it would be more reasonable for the regulations to provide that a system operator meets its audit response burden if it provides the auditor with information in the form of reports that include the number of subscribers, the amount of revenue and the numbers of subscribers and revenues applicable to specific service offerings at the system level in a manner sufficient to allow the audit to be conducted under generally accepted accounting standards." AT&T Comments at 4. This appears to be an attempt to have the Office set a special set of accounting standards to apply to these audits in lieu of having the audits conducted in accordance with generally acceptable accounting principles ("GAAP").

Putting aside the question of whether the Office has the expertise or the authority to establish specialized accounting standards for these audits in lieu of following GAAP, AT&T's preferred approach appears to conflict with the requirement that auditors comply with AICPA standards. NPRM at 27,151 (proposed § 201.16(e)). The AICPA Code of Professional Conduct contains a strong presumption in favor of following GAAP except in unusual circumstances. *See generally* AICPA Code of Professional Conduct ET Section 203, *available at* http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/sec200.aspx. AT&T's claim of undue burdens and costs, aside from being refuted by CBO's finding of minimal burden, NPRM at 27,148, does not fit within the definition of unusual circumstances to justify a departure from GAAP.

AT&T's alternative audit rights standards would rely on licensee-generated and ill-defined subscriber and revenue "information in the form of reports" that would not provide the level of certainty associated with a GAAP audit. Accordingly, it should be denied as an unjustified deviation from GAAP. Auditors should be free to request whatever information they need to fulfill their responsibility. Providing the requested information is, as the Office noted, "simply a cost of doing business under the statutory licensing system." NPRM at 27,148. As such, it does not rise to the level of unusual circumstances that would justify deviation from following GAAP in the audit rights procedures.

C. <u>A Certified Community-By-Community List of Stations Carried Benefits All Parties</u>

Proposed Section 201.16(g)(1) requires that an audited licensee "provide the auditor and a representative of the participating copyright owner(s) with a certified list of all broadcast signals retransmitted . . . in each community . . . [including] the classification of each signal on a community by community basis." NPRM at 27,151. Despite its inclusion, the Office sought "comment on whether there is any benefit in requiring licensees to provide information that should be apparent from the face of their Statements of Account." *Id.* at 27,141.

While the new Form 3, but not the old Form 3 or Form 1/2, SOAs do require identification of different channel line-ups linked to different subscriber groups, that information can be quite unwieldy and difficult, if not impossible, to parse. Contrary to the Office's view, needed information about what signals are retransmitted in each community for large cable systems can be unraveled from the SOA information only with great difficulty. Providing a list of what stations, local and distant, are retransmitted to each community provides the auditor with a readily available means of verifying the carriage of those stations in each of the relevant communities.

Receipt of this information was an important component of the Joint Proposal, which removed issues relating to the basis of carriage from the scope of the audit (a limitation that did not exist in the Office's original proposal). Copyright Owners agreed to narrow the scope of the audit in return for a mechanism that allows the auditor to verify the carriage of stations in particular communities, information that Copyright Owners can then utilize to determine whether a statutory licensee has correctly classified the carriage of its stations.[3]

The new SA3 Long Form SOA requires a system to list each community served along with its channel line-up and subscriber group designation in Space D; the new Space G instructions indicate that for "multiple channel line-ups, use a separate Space G for each channel line-up." Systems that have multiple subscriber groups must also report in Part 9, Block A of the DSE Schedule what *distant* signals are carried to each subscriber group on either a permitted or a non-permitted basis. Presumably, the Office felt that by matching the information from these sources, the identity of which stations are retransmitted to which communities can be determined. Of course, for SOAs that do not have these requirements, many of which are still subject to possible audit, it is impossible to link communities with reported local stations.

The information on the new Form 3 SOA might be sufficient to match communities and stations for systems having one or two subscriber groups and one or two separate channel line-ups, but as the trend toward larger and larger Form 3 systems accelerates, the difficulty of matching stations and communities becomes more and more fraught with complications and complexity. For example, an unscientific, random look through 2012/2 Form 3 SOAs found: Comcast of Southeast PA LLC (LOC No. 6580) listed 589 communities, 30 channel line-ups with between 7 and 49 stations each, and 46 subscriber groups; Time Warner Northeast LLC (LOC No. 6482) lists 257 communities, 17 channel line-ups with between 9 and 21 stations each, and 51 subscriber groups; Charter CC VIII Operating LLC (LOC No. 8646) lists 82 communities, 11 channel line-ups with between 14 and 20 stations each, and 28 subscriber

[3] In the absence of a voluntary payment by the statutory licensee, Copyright Owners would still have to initiate infringement litigation in cases where statutory licensees have incorrectly classified the carriage of a particular station on a statement of account.

groups; and, Bright House Networks LLC (LOC No. 20503) lists 71 communities, seven channel line-ups with between 19 and 26 stations each, and 11 subscriber groups.

Parsing through these combinations to identify the stations available to each community presents a long, arduous task for the auditor. Once cable operators provide a list of signals carried in each community, the auditor's task will then be limited to determining whether the cable operator's description is in fact accurate.

Beyond that determination, questions of whether distant carriage is properly classified as permitted or non-permitted turn on the number and type of local signals retransmitted to a particular subscriber group as well as the market in which the group is located. An auditor will not address whether signals are properly classified as distant or local or as permitted or non-permitted for royalty purposes. *See* NPRM at 27,142 (auditor will verify "all information reported on the Statements of Account subject to the audit in order to confirm the correctness of calculations and royalty payments therein." (quotation omitted)). Nonetheless, providing a certified list of both distant and local stations retransmitted to each community will enable an auditor to verify quickly and easily whether the statutory licensee has in fact accurately reported on the SOA the stations carried in particular communities.

Simultaneously providing the list to the copyright owner(s) requesting the audit will enable the owner(s) to determine whether they agree with the audited system's signal classification. If they do not, their concerns can be raised with the cable system during the audit, which creates an opportunity for such concerns to be addressed and resolved prior to completion of the audit process. If these disagreements can be resolved during the audit process, then royalty adjustments, if needed, can be made as part of the audit correction and curing procedure. *See* NPRM at 27,145-46 (discussing procedures). This approach would benefit the parties by avoiding costly, time-consuming litigation about signal classification questions and by providing certainty about how the audited system's retransmitted signals should be treated for royalty purposes.

ACA and AT&T's claims of burden in providing these lists are misplaced. To have an auditor attempt to match station carriage in individual communities, particularly for systems that cover large geographic areas and have multiple channel line-ups and numerous subscriber groups, will be cumbersome and costly. Presumably, the cable system is more likely to know what stations it carries in each community from providing such information repeatedly in its SOAs and its promotional materials, thereby easing the task of putting together the verified list in comparison to requiring an auditor to undertake this task.

For these reasons, the Copyright Owners submit that the requirement for a licensee to provide a certified list of the stations and their designation in each community served provides tangible benefits that will promote the efficiency and effectiveness of the audit rights process.

Respectfully submitted,

PROGRAM SUPPLIERS

Dennis Lane
D.C. Bar No. 953992
STINSON MORRISON HECKER LLP
1775 Pennsylvania Avenue NW, Suite 800
Washington, D.C. 20006
Telephone: (202) 572-9906
Fax: (202) 572-9981
DLane@stinson.com

JOINT SPORTS CLAIMANTS

Philip R. Hochberg/ITR

Philip R. Hochberg
D.C. Bar No. 5942
LAW OFFICES OF PHILIP R. HOCHBERG
12505 Park Potomac Avenue
Potomac, MD 20854
Telephone: (301) 230-6572
PHochberg@shulmanrogers.com

PUBLIC TELEVISION CLAIMANTS

Ronald G. Dove, Jr. /lm

Ronald G. Dove, Jr.
D.C. Bar No. 430533
Lindsey Tonsager
D.C. Bar No. 983925
COVINGTON & BURLING LLP
1201 Pennsylvania Avenue, NW
Washington, D.C. 20004-2401
Telephone: (202) 662-5685
FAX: (202) 662-5685
rdove@cov.com

CANADIAN CLAIMANTS GROUP

L. Kendall Satterfield /lm

L. Kendall Satterfield
D.C. Bar No. 393953
FINKELSTEIN THOMPSON LLP
James Place
1077 30th Street, NW
Suite 150
Washington, D.C. 20007
Telephone: (202) 337-8000
Fax: (202) 337-8090
ksatterfield@finkelsteinthompson.com

DEVOTIONAL CLAIMANTS

Arnold P. Lutzker /lm

Arnold P. Lutzker
D.C. Bar No. 101816
LUTZKER & LUTZKER LLP
1233 20th Street, NW, Suite 703
Washington, D.C. 20036
Telephone: (202) 408-7600
Fax: (202) 408-7677
arnie@lutzker.com

NATIONAL PUBLIC RADIO

Gregory A. Lewis /lm

Gregory A. Lewis
D.C. Bar No. 420907
NATIONAL PUBLIC RADIO
635 Massachusetts Avenue, NW
Washington, DC 20001-3753
Telephone: (202) 513-2050
Fax: (202) 513-3021
glewis@npr.org

AMERICAN SOCIETY OF COMPOSERS, AUTHORS AND PUBLISHERS

Samuel Mosenkis /DR

Joan M. McGivern
Samuel Mosenkis
N.Y. Bar No. 2628915
ASCAP
One Lincoln Plaza
New York, NY 10023
Telephone: (212) 621-6450
Fax: (212) 787-1381
smosenkis@ascap.com

BROADCAST MUSIC, INC.

Joseph J. DiMona /DR

Joseph J. DiMona
D.C. Bar No. 412159
BROADCAST MUSIC, INC.
7 World Trade Center
250 Greenwich Street
New York, NY 10007-0030
Telephone: (212) 220-3149
Fax: (212) 220-4447
jdimona@bmi.com

SESAC, INC.

John C. Beiter /DR

John C. Beiter
Tennessee Bar No. 12564
SHACKELFORD, ZUMWALT & HAYES
1014 16th Avenue South
Nashville, TN 37212
Telephone: (615) 256-7200
Fax: (615) 256-7106
jbeiter@shacklaw.net

Michael J. Remington /DR

Michael J. Remington
D.C. Bar No. 344127
Jeffrey J. Lopez
D.C. Bar No. 453052
DRINKER BIDDLE & REATH LLP
1500 K Street, NW – Suite 1100
Washington, D.C. 20005
Telephone: (202) 842-8800
Fax: (202) 842-8465
michael.remington@dbr.com
jeffrey.lopez@dbr.com

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