

**EXECUTIVE SUMMARY****CHAPTER I – A HISTORICAL INTRODUCTION TO THE STATUTORY LICENSES**

This Chapter provides an overview of the statutory licenses, a brief history of their creation and purpose, the mission of this Report, and similar reporting efforts made by the Copyright Office (“Office”) and the Federal Communications Commission (“FCC”) in the past. The main points of this Chapter are as follows:

- Three statutory licenses in the Copyright Act (“Act”) govern the retransmission of distant and local over-the-air broadcast station signals. There is one statutory license applicable to cable television systems and two statutory licenses applicable to satellite carriers.
- The Section 111 license permits a cable operator to retransmit both local and distant radio and television signals to its subscribers who pay a fee for such service. The purpose of Section 111 is to permit cable systems to carry distant broadcast signals while compensating copyright owners for the public performance of their works, without the transaction costs associated with marketplace negotiations for the carriage of copyrighted programs. Section 111 allows cable operators to complement the carriage of local broadcast signals with distant signal programming that is generally unavailable in local markets. Congress enacted Section 111 after years of industry input and in light of (1) FCC regulations that inextricably linked the cable and broadcast industries and (2) the need to preserve the nationwide system of local broadcasting.
- The Section 119 license permits a satellite carrier to retransmit distant television signals (but not radio signals) to its subscribers for private home viewing and to commercial establishments. The purpose of the Section 119 license is to provide satellite carriers with an efficient way of licensing copyrighted works contained in a broadcast signal so that a satellite carrier could offer superstations to a home dish owner anywhere in the

United States and network programming to a household that could not receive adequate over-the-air signals from local network affiliates.

- The Section 122 statutory license permits satellite carriers to retransmit local television signals into the stations' local market on a royalty-free basis. The license is contingent upon the satellite carrier complying with the rules, regulations, and authorizations established by the FCC governing the carriage of television broadcast signals. The principal purpose of Section 122 is to provide local television broadcast signals to satellite subscribers in their local markets. The secondary purpose of Section 122 is to promote competition between satellite carriers and cable operators by permitting a parallel array of local programming.
- Section 109 of the Satellite Home Viewer Extension and Reauthorization Act of 2004 requires the Office to examine and compare the statutory licensing systems for the cable and satellite television industries under Sections 111, 119, and 122 of the Act and recommend any necessary legislative changes no later than June 30, 2008. The legislative history states that the Office must analyze the differences among the three licenses and consider whether they should be eliminated, changed, or maintained with the goal of harmonizing their operation.
- Congress indicated that the report shall include, but not be limited to, the following:
  1. A comparison of the royalties paid by licensees under Sections 111, 119, and 122, including historical rates of increases in these royalties, a comparison between the royalties under each such section and the prices paid in the marketplace for comparable programming;
  2. An analysis of the differences in the terms and conditions of the licenses under such sections, an analysis of whether these differences are required or justified by historical, technological, or regulatory differences that affect the satellite and

cable industries, and an analysis of whether the cable or satellite industry is placed in a competitive disadvantage due to these terms and conditions;

3. An analysis of whether the licenses under such sections are still justified by the bases upon which they were originally created;
4. An analysis of the correlation, if any, between the royalties, or lack thereof, under such sections and the fees charged to cable and satellite subscribers, addressing whether cable and satellite companies have passed to subscribers any savings realized as a result of the royalty structure and amounts under such sections; and
5. An analysis of issues that may arise with respect to the application of the licenses under such sections to the secondary transmissions of the primary transmissions of network stations and superstations that originate as digital signals, including issues that relate to the application of the unserved household limitations under Section 119 and to the determination of royalties of cable systems and satellite carriers.

The Chapters that follow address these issues.

## **CHAPTER II – THEN AND NOW**

This Chapter discusses the specific changes in the marketplace since the statutory licenses were created. The growth of the cable and satellite industries is shown and recent data is included which illustrates how they are no longer small nascent services with few subscribers. This historical picture is compared against recent developments in the marketplace, including the introduction of new distribution technologies by AT&T and Verizon. Their operations are specifically discussed and points are made about how they are structurally different from traditional cable systems. The rapid ascent of the Internet as a major outlet for the distribution of video programming is also extensively highlighted and industry

trends are summarized to show how online video consumption is expanding at the expense of traditional media outlets. In addition, the advent of digital television is recognized and a discussion is presented regarding how this new broadcast technology, with the ability to multicast, differs from the analog system of broadcasting. Finally, changes in royalties and distant signal carriage patterns over the last thirty years are thoroughly analyzed. The data indicate, *inter alia*, that distant broadcast signals represent a minute portion of the overall cable and satellite channel lineups. The main points of the Chapter are as follows:

- Recent changes in the video programming marketplace and in video distribution technology are shaking the foundations of the communications industry and the law. The Internet, digital television, and video services using Internet Protocol, have changed the way individuals receive and consume all types of media. Traditional cable and satellite services are losing subscribers and market share to these newer technologies. There is also less interest in programming retransmitted over distant broadcast signals as a result of these new platforms and systems. These fundamental shifts call into question the appropriateness of the current statutory licensing systems in the Act.
- The Internet has developed into a robust platform for the provision of video programming. Television networks, their local affiliates, independent television stations, and public broadcasting entities currently offer news, sports, and entertainment programming through their own websites. They have also negotiated private licensing agreements with a number of online video aggregators to download, stream, or share their content over the Internet. Broadcast programming is also available on mobile devices via wireless broadband delivery systems, again under private licensing agreements. The Internet market is thriving and continues to grow without any statutory licensing in place. The economic rationales for “compulsory” licensing are waning, and less justifiable, in light of the success of the Internet.
- AT&T and Verizon have built new distribution platforms that can deliver more programming and services than traditional cable and satellite systems. They each use a

different type of technology to provide their customers with video, voice, and broadband. AT&T favors Internet Protocol technology to deliver television services while Verizon has built a fiber-to-the-premises physical plant to do the same. However, they are both “national” in scope as each of their systems aggregate programming at different technological points across many states and jurisdictions. These systems are quite different than those used by traditional cable operators and satellite carriers in the past. As such, AT&T and Verizon do not neatly fit within the confines of the current statutory licenses. Nevertheless, as discussed further in Chapter V, both AT&T and Verizon’s operations can be viewed as cable systems and consequently, they may use the Section 111 license to retransmit broadcast signals, provided that they adhere to all of the FCC’s broadcast signal carriage rules.

- Broadcast television stations are changing the scope and breadth of their services, too. Digital television technology allows broadcasters to provide more programming choices to over-the-air viewers as well as to cable and satellite subscribers. Digital television stations now provide a mix of high definition and standard definition broadcast signals and may possibly offer interactive television services in the future. More importantly, such stations are able to “multicast” by splitting their digital signals into smaller streams each of which may be independently programmed. It is axiomatic that the digital television transmissions are much different than traditional analog transmissions. For that reason, the existing distant signal licenses, whose foundations were built upon analog broadcast technology, cannot readily accommodate the vibrant capabilities of digital television.

### **CHAPTER III – LICENSING, PROGRAMMING, AND THE MARKETPLACE**

This Chapter discusses the means by which to determine marketplace rates for programming carried on distant signals, whether the royalties paid under the licenses approximate marketplace rates, how the distant signal licenses have interfered in the market, the effects of the licenses on subscribers, what the market would look like if there were no statutory licenses, and what free market mechanisms

exist for replacing the distant signal licenses. The overall findings in this Chapter are that royalty rates are below marketplace rates, that the current distant signal licenses have served their purpose but are no longer necessary, and that Sections 111 and 119 of the Act have outlived their original purposes. The main points in this Chapter are as follows:

- It is not unreasonable to compare non-broadcast networks with distant broadcast signals for purposes of determining the marketplace value of copyrighted programming. The data in the record strongly indicate that cable operators and satellite carriers are paying less for the privilege of retransmitting distant broadcast signals than they are in paying license fees to comparable non-broadcast networks. Ultimately, the only way to assess the value of broadcast programming is to allow marketplace negotiations. The best example is the cost of TBS, which shows a marked increase in its valuation when unconstrained by the statutory licenses.
- Retransmission consent is essentially a statutorily created “right” given to commercial broadcast stations. Copyright owners of the programs carried on such stations do not benefit financially from agreements between broadcasters and cable operators or satellite carriers. As such, it is not an appropriate benchmark by which to compare statutory royalty rates. Further, retransmission consent is part of a thicket of communications law requirements aimed at protecting and supporting the broadcast industry. The value assigned to the carriage of a station, apart from the performance right of the programming retransmitted on a signal, cannot be parsed out because of this regulatory entanglement.
- Based on the record in this proceeding, it appears that the royalties in the statutory licenses are set at below-market levels. Below-market rates may have been justifiable when cable and satellite were nascent industries and needed a mechanism to allow them to serve their subscriber base with valuable distant signals. However, the current multichannel video distribution marketplace is robust and has, for a long time, overshadowed the broadcast industry. It is now time to phase out Section 111 and

Section 119 so that copyright owners can negotiate market rates for the carriage of programming retransmitted by multichannel video programming distributors.

- The record evidence in this proceeding supports the long held view that the distant signal licenses have interfered in the marketplace for programming and have unfairly lowered the rates paid to copyright owners. The time has come when private negotiations would serve the public interest, and interests of the creative community, better than either Section 111 or Section 119. Creativity flourishes in a competitive marketplace. New business models, benefitting content owners and distributors, are able to blossom free from government restrictions. The cable and satellite industries are no longer dependent upon distant signals as they were at the outset of the licenses, so repealing the distant signal licenses would not have the dramatic effect it would have had years ago.
- Section 111 has proven to be an efficient mechanism to clear copyrighted works at below-market rates. However, this does not mean that the statute is still necessary or desirable. The cable industry has grown significantly since 1976, in terms of horizontal ownership as well as subscribership, and generally has the market power to negotiate favorable program carriage agreements. Cable operators now have the ability to negotiate with copyright owners for the retransmission of content carried on distant broadcast signals, as they now do with non-broadcast networks. The transaction costs associated with clearing copyrights are not as burdensome as they may have been and can be overcome through marketplace solutions.
- Section 119 was originally enacted to provide households with distant network station service where local broadcast service from network affiliates was unavailable. Essentially, the license was a stop-gap solution for a nascent satellite industry. DirecTV and Echostar did not serve any customers in 1988, but now count more than 30 million subscribers in the aggregate representing over 30% of the multichannel video distribution market. Like cable operators, they, too, have the market power and bargaining strength to negotiate favorable program carriage agreements. With the advent of Section 122,

satellite households now have access to local network stations in over 175 television markets, thus reducing the need to import distant network signals. Section 119 in its present form, undergirded by outdated rationales set forth in 1988, is no longer necessary nor appropriate.

- After a comprehensive review of the record, and noting the rapid changes in the video programming marketplace, the Office's principal recommendation is that Congress should abandon Sections 111 and 119 of the Act. The need for these statutory licenses has dissipated over time. There are many types of private mechanisms that have developed that can effectively replace these two licenses.
- Nevertheless, immediately eliminating access to distant broadcast signals may cause disruptions to distributors and viewers alike. The Office therefore recommends that Congress adopt a new short term statutory license built around digital television technology. The Office envisions a five year license that would commence on January 1, 2010 and end on December 30, 2014. By the year 2015, issues associated with the digital transition will be settled, broadband penetration will have substantially increased, and households will be able to receive broadcast-type video programming from a multitude of different providers. It will be a whole new era by then, and the copyright law should be able to reflect that fact.
- Collective licensing may be a suitable substitute for the distant signal licenses in any event. While the existing collective licensing structures are directed at musical works, they may nevertheless prove to be an avenue to clear video programming. The Office anticipates that collective licensing is one type of marketplace arrangement that users and copyright owners may consider to clear broadcast television programming content.
- Sublicensing is another possible, and reasonable, alternative to statutory licensing. Sublicensing permits broadcast stations to act as copyright clearance agents so that programming may be retransmitted by multichannel video programming distributors. It is

a market driven concept that has been in practice as long as cable operators have carried non-broadcast networks. In fact, sublicensing has been so successful that there are now over 500 channels of video programming available for distribution in the multichannel marketplace. The current distant signal licenses have impeded the development of a sublicensing system. This is another reason why the Office recommends that the statutory licensing system for distant signals should be phased out.

#### CHAPTER IV – DISPARITIES AND SOLUTIONS

This Chapter discusses the historical, technical, and regulatory disparities between Section 111 and Section 119, the difficulties in completely harmonizing their operations, and suggestions for reforming the licenses to bring them closer together in form and function. The Office has recommended a number of ways to fix the distant signal licenses if Congress decides to keep them separate. The changes suggested by the Office have four overarching purposes: (1) to simplify the existing statutory licenses; (2) to eliminate reliance on old regulatory structures; (3) to increase parity between cable systems and satellite carriers; and (4) to reduce reliance on distant broadcast signals by the affected industries. However, the Office has noted throughout this Chapter that modifying the licenses is a difficult task because the provisions of Section 111, and Section 119 to some extent, are tightly knotted together into a larger regulatory fabric. The addition or subtraction of certain provisions may have the unintended consequence of harming program distributors, copyright owners, and subscribers. The main points of this Chapter are:

- Any changes to the Section 111 statutory structure will disrupt settled expectations. But, the current system is deeply flawed and is in need of several legislative changes to make it functional in the current and future marketplace. First and foremost, Section 111 needs to be changed to accommodate digital broadcast television. Second, Section 111 needs to be updated to reflect current FCC rules, regulations, and definitions. Third, Section 111 needs to be amended to accommodate changes in the size and structure of the cable industry. Fourth, the royalty structure should be simplified to make it administratively efficient for users of the license, copyright owners, and Copyright Office examiners.

Finally, the modifications should bring the two distant signal licenses closer together so they operate on parallel tracks.

- The Office offers several suggestions to fix the cable statutory license, and these are discussed throughout this Chapter. The most significant recommendation is to replace the gross receipts royalty system with a flat fee per subscriber system. There are many more reasons in favor of switching from the current system to one based on flat fees than there are drawbacks. For example, the adoption of a flat fee system would:
  1. Eliminate the need for a definition of a cable system for purposes of calculating royalties, which in turn, would solve the phantom signal issue and avoid the artificial fragmentation of larger systems for purposes of lowering copyright payments.
  2. Eliminate the outdated DSE system for valuing distant broadcast signals.
  3. Eliminate reliance on outdated FCC regulations, such as the market quota rules.
  4. Eliminate the need to account for tiering and equipment revenue generated by cable systems.
  5. Provide the basis for eliminating the “minimum fee” for the privilege of retransmitting distant signals.
  6. Eliminate the need for a headend definition.
  7. Reduce the Statement of Account administrative burden for users of the license and the Copyright Office.

- The Office offers several suggestions to fix the satellite statutory license. The most significant recommendation is to repeal the unserved household provision. The Office’s task in this Report is to analyze the unserved household provision in the context of competition between cable operators and satellite carriers. The Office finds that the provision’s subscriber eligibility requirements, which only appear in Section 119, create a competitive disparity between satellite carriers and cable operators. The Office therefore recommends that Congress consider eliminating the unserved household provision, and attendant language about contours and testing, if it decides to retain Section 119. In its place, and to protect copyright owners, the Office recommends imposing the same exclusivity rules now applicable to cable operators on the satellite retransmission of distant network signals. The network nonduplication and syndicated exclusivity provisions have worked better in protecting the interests of copyright owners in the cable context than the unserved household provision has in the satellite context because the former are easier to administer and understand. While the application of exclusivity rules may be technically complicated, the Office’s recommendation would effectively level the playing field between cable operators and satellite carriers.
- Section 111 does not limit the amount of distant signals a cable operator may retransmit, as long as the appropriate royalty payment is made. However, satellite carriers are more limited in the number of distant network stations they may now transmit. In order to remedy this disparity, the Office recommends establishing a cap on distant signals in Section 111, effective during the post-digital television transition period. Cable operators would be permitted to retransmit up to four distant network station signals and import one additional distant non-network (superstation) signal.

## CHAPTER V – NEW DISTRIBUTION TECHNOLOGIES

This Chapter discusses new distribution technologies and whether they should be included in the statutory licensing paradigm. The principal finding here is that new systems that are substantially similar to those systems that already use Section 111, should be subject to the license. Thus, systems that use

Internet Protocol to deliver video programming, but are the same in every other respect to traditional cable operators, should be eligible to use Section 111 to retransmit broadcast signals, provided that these systems abide by the same broadcast signal carriage statutory provisions and FCC exclusivity requirements currently applicable to cable operators.

Several businesses are using, or plan to use, the Internet to retransmit broadcast programming. The Office recommends that businesses using the Internet to deliver video programming should not be eligible for a statutory license at least at this time. First, there are serious questions about signal security that need to be addressed. Second, the United States has entered into a number of Free Trade Agreements with several international trading partners that include provisions prohibiting statutory licensing for the retransmission of broadcast content over the Internet. Third, carriage of programming on the Internet has been subject to marketplace negotiations and private licensing with some degree of success. As such, there is no market failure warranting the application of a statutory license in this context. An Internet statutory license would likely remove incentives for individuals and companies to develop innovative business models.

## **CHAPTER VI – A NEW UNIFIED LICENSE**

This Chapter provides recommendations on the structure and provisions of a new statutory regime for the retransmission of broadcast signals. It borrows several of the suggestions from the earlier discussion on modifying the existing licenses if they are to be separately maintained. The goal of the new license would be to provide a lifeline distant broadcast signal service to subscribers that does not radically compromise broadcast localism. The new regime also would include provisions allowing users to retransmit local television and radio signals on a royalty-free basis. The plan would be for Congress to enact the new license when Section 119 expires at the end of 2009. The intent is to provide users with a short-term five year license so that subscribers are able to receive a limited set of distant network and non-network (superstation) television signals in the early years after the DTV transition. This recommendation attempts to track current retransmission patterns under the existing licenses and is intended to provide subscribers with programming they currently receive. At the end of the five year

license period, the distant signal provisions would sunset and Congress could then consider whether to maintain the license for the purpose of permitting local-into-local transmissions of broadcast signals.

This approach recognizes the many changes brought forth by the digital television transition in 2009. This new license would update and harmonize the existing statutory licenses and provide an interim answer to the distant signal question, at least until marketplace solutions ultimately take hold. In crafting such a license, the Office recommends that Congress take into consideration the following goals of: (1) adopting a rational marketplace based royalty structure for copyright owners and users of the license; (2) providing subscribers with access to local and in-state digital broadcast signals to the extent feasible; and (3) allowing the retransmission of a limited amount of distant network and non-network (superstation) signals. The proposed terms and conditions of the new license are fully addressed in this Chapter.

## **CHAPTER VII – THE CURRENT LICENSES**

This Chapter considers the reasons for retaining the current statutory licenses and concludes that the distant signal licenses, as presently configured, are no longer justified by the bases upon which they were originally created. The Office concludes that Section 111 and Section 119 should not be maintained in their current form. New technologies, the digital television transition, and other developments have created fissures in both Section 111 and Section 119 making them ill-suited for digital broadcasting and new business models yet to be developed. Whatever rationales that Congress used to support these licenses at their inception are no longer sound. However, the Office finds that the Section 122 local-into-local license should be retained, as a stand-alone provision, or as part of a new license, because it still furthers the goals of providing local service to satellite subscribers and promotes inter-industry competition. If Section 111 is repealed, Section 122 should be amended to allow cable operators to retransmit local broadcast station signals on a royalty-free basis as a means to achieve a greater degree of parity between operators and satellite carriers.

- **CHAPTER VIII – RECOMMENDATIONS**

This Chapter provides a summary of the recommendations made throughout the Report. As stated above, the principal recommendation is that Congress move toward abolishing Section 111 and Section 119 of the Act. The cable and satellite industries are no longer nascent entities in need of government subsidies through a statutory licensing system. They have substantial market power and are able to negotiate private agreements with copyright owners for programming carried on distant broadcast signals. The Office finds that the Internet video marketplace is robust and is functioning well without a statutory license. The Office concludes that the distant signal programming marketplace could be equally successful if Section 111 and Section 119 were repealed. The Office nevertheless recommends the retention of a royalty-free local-into-local license because it promotes the general welfare of users, broadcasters, and the public.

Despite the Office's determination that the ultimate solution should be the elimination of the existing distant signal licenses, it recognizes that the digital television transition in 2009 is likely to generate unanticipated signal reception problems for millions of American households. The Office finds that it is important for Congress to provide for a lifeline distant signal service of four network station signals and one non-network (superstation) signal during the post-transition period. The Office therefore recommends the establishment of a new statutory licensing system that would cover the retransmission of distant broadcast signals beginning on January 1, 2010 and ending on December 31, 2014. This will permit users of the license to serve the needs of their subscribers who may experience viewing disruptions. Summaries of the new license, and modifications to the existing licenses, are presented for a final time in this Chapter.