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Statutory Cable, Satellite, and DART License Reporting Practices	))	Docket No. 2005-6

COMMENTS OF
NCTA – THE INTERNET & TELEVISION ASSOCIATION

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NCTA – The Internet & Television Association ("NCTA") hereby submits its comments to the Copyright Office ("Office") in response to the above-captioned Notice of Proposed Rulemaking ("NPRM").[1/] NCTA is the principal trade association for the cable industry in the United States, representing cable operators that serve approximately 85% of the nation's cable television households and that pay most of the cable compulsory license royalty fees deposited with the Office pursuant to Section 111 of the Copyright Act (17 U.S.C. § 111).

INTRODUCTION & SUMMARY

The Office issued the NPRM to consider a number of proposed changes to its rules and forms implementing the Section 111 cable compulsory license.[2/] Several of the proposed revisions have their origins in a 2006 Notice of Inquiry ("NOI") proceeding that the Office commenced in response to a petition for rulemaking filed by the Motion Picture Association of America ("MPAA") in 2005.[3/] NCTA filed comments and reply comments in response to the

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1/ *Statutory Cable, Satellite, and DART License Reporting Practices*, 82 Fed. Reg. 56926 (Dec. 1, 2017) ("*NPRM*").

2/ Most of the revisions to the Office's rules and forms proposed in the NPRM apply equally to the "Long Form" Statement of Account ("SOA") (SA3) and the "Short Form" SOA (SA1-2). References in these comments to SOAs will encompass both the SA3 and SA1-2 Forms unless otherwise specified.

3/ *See* MPAA, Petition for Rulemaking, Docket No. 2005-06 (filed June 7, 2005) ("*2005 MPAA Petition*"); *Cable Compulsory License Reporting Practices*, 71 Fed. Reg. 45749 (Aug. 10, 2006) ("*NOI*").

NOI, opposing most of the revisions proposed by MPAA.[4/] Nonetheless, subsequent to the release of the NPRM, NCTA consulted with MPAA to see whether agreement could be reached on particular issues. The Office should note that there are instances in which the positions taken by NCTA and MPAA are in accord.

Briefly summarized, the comments below demonstrate that –

- the enactment by Congress in 2014 of an amendment to the Copyright Act granting copyright owners an expansive new "verification" (or "audit") right as a tool for assessing the accuracy of a cable operator's compulsory license royalty calculations obviates the need (to the extent there was any need) for most, if not all, of the additional reporting requirements originally proposed by MPAA in 2005;

- in today's highly competitive video marketplace, a cable operator's undiscounted "rate card" prices are a poor indicator of a system's actual "gross receipts" for purposes of Section 111 and, thus, requiring more information about rate card prices would serve no purpose given the industry's now widespread use of discounted pricing for multiple-element packages (or "bundles") of video and non-video services as a means of competing in the marketplace;

- instead of imposing new paperwork obligations on cable operators, the Office's objective in this proceeding should be to streamline the SOA forms by eliminating unnecessary reporting requirements, such as those in Space E and Space F;

- the Office's proposed amendment to the definition of "gross receipts" would effectively impose cable compulsory license royalties on Internet and voice service revenues and, as such, is contrary to Congress' intent to base Section 111 royalties on a cable operator's revenues from the basic service of retransmitting broadcast signals;

- to the extent that the gross receipts definition needs to be clarified, the Office should recognize Generally Accepted Accounting Principles ("GAAP") as the governing set of standards for reporting gross receipts under Section 111;

- GAAP is not only the set of authoritative and neutral accounting standards by which cable operators already are required to keep their books for a wide range of financial reporting purposes, it also is the set of standards adopted by the Office

[4/] Comments of NCTA, Docket No. 2005-6 (filed Sept. 25, 2006) ("*NCTA NOI Comments*"). Reply Comments of NCTA, Docket No. 2005-6 (filed Oct. 24, 2006).

and the Copyright Royalty Board to govern revenue recognition under several other statutory copyright licenses;

- under GAAP, discounts offered to subscribers of multiple-element packages, such as "double play" and "triple play" bundles combining video and Internet and/or voice services for a single price, are allocable proportionally among the components of the package;

- the Office also should abandon its proposed amendment to its "cable system" definition and instead leave to the courts and Congress the task of addressing the eligibility of new technologies and platforms for the Section 111 compulsory license; and

- the Office should reconsider various other proposed modifications to a cable operator's reporting obligations (such as the requirement to report additional headend location and community information) that are unnecessary or would impose costs that outweigh the benefits, if any, of the proposed modifications.

DISCUSSION

I. THE OFFICE SHOULD NOT REQUIRE CABLE OPERATORS TO PROVIDE UNNECESSARILY DETAILED SUBSCRIBER AND RATE INFORMATION ON THEIR SOA FORMS.

The NPRM solicits comment on whether cable operators should be required to provide an explanation when the amount of gross receipts produced by multiplying the subscribership and rate information reported on Space E does not closely match the amount of gross receipts reported on Space K of their SOAs.[5/] The Office also seeks comment on whether it should modify the SOA forms to increase the level of detail that an operator is required to provide on Space E regarding its services, rates and subscribership.[6/] These proposals are unnecessary and move in the wrong direction. Consistent with the Administration's deregulation initiative and the Office's ongoing efforts to improve its overall efficiency, the Office should consider

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5/ *NPRM*, 82 Fed. Reg. at 56928-31.

6/ *Id.*

reducing, not increasing, unnecessary burdens on cable operators and even eliminating some reporting requirements in their entirety.[7/]

A. Requiring Cable Operators to Explain Variations Between the Gross Receipts Reported on Space K and Subscriber and Rate Information Reported on Space E is Neither Necessary Nor Appropriate.

One of the centerpieces of the 2005 MPAA Petition was a proposal that cable operators be required to use the rate and subscribership information on Space E to calculate an "approximate" gross receipts total and to explain any variation of more than ten percent between that amount and the amount of gross receipts reported on Space K. While the Office seeks comment on this proposal, it tentatively (and rightly) concludes that the proposal would go beyond what has been required, may be inappropriate in light of differences in how data is reported in Space E and Space K, and would impose significant additional resource burdens on the Office's Licensing Division by requiring it to assume a far greater role in examining SOAs than has heretofore been the case.[8/]

NCTA agrees with the Office's tentative conclusions. Indeed, requiring the "explanation" described in the NPRM would be a pointless and misleading exercise. As NCTA has previously explained, there are a host of variables that impact the gross receipts reported on Space K that are not reflected in Space E, including changes in subscribership and rates over time, credits for service outages, bad debt, etc.[9/] Furthermore, the prices that cable subscribers actually pay for basic cable service are now often impacted by the industry's widespread use of discounted pricing for packages (or "bundles") of services including video, Internet, and voice services, as well as other promotional discounts. Thus, as has been obvious for many years,

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7/ Exec. Order No. 13771, 3 C.F.R., 2017 Comp., pp. 284-85 (2017).

8/ *Id*. at 56929.

9/ *See NCTA NOI Comments*, at 5-6.

simply multiplying an operator's Space E rate card and subscribership information will not match the amount that subscribers actually paid for basic service and will overstate both the amount of revenue actually collected by cable operators for basic service and the amount that is reported as "gross receipts" on Space K.[10/] Therefore, the premise that a special explanation is required every time Space E and Space K do not match makes no sense.

B. The Office Should Not Increase the Level of Detail Regarding Rates and Subscribership that a Cable Operator Must Report on Space E.

The NPRM states that "it may be advisable to update" Space E to require cable operators to provide a "somewhat more granular breakdown" of subscriber and rate information.[11/] According to the Office, these changes would "address concerns about the adequacy of reported information."[12/] In fact, increasing the amount of granular information that an operator has to report on Space E will not achieve the Office's goal – it will merely add a new level of complexity to the task of completing the forms without increasing the accuracy or utility of the information provided therein. As described more specifically below, it makes far more sense for

10/ The audit procedures established by Congress in the Satellite Television Extension and Localism Act of 2010, Pub. L. No. 111-175, §§101, 104, 124 Stat. 1218, 1220, 1232 ("STELA"), already provide copyright owners an additional tool to confirm the accuracy of a cable operator's reported gross receipts and thus negate the need for operators to "explain" or otherwise reconcile the information in Space E with the information in Space K. While the Office suggests that the statutory audit process is not likely to assure that "every single SOA would be audited," *NPRM*, 82 Fed. Reg. at 56929, selective audits are commonly relied on to promote industry-wide compliance with regulatory obligations. For example, the FCC relies upon selective audits to assure cable operator compliance with federal lifeline programs that subsidize voice services; specialized equal employment opportunity requirements; leakage monitoring and maintenance of repair logs that are essential parts of the federal arrangement for cable systems and airline navigation to share common frequencies; and emergency alert requirements.

11/ *NPRM*, 82 Fed. Reg. at 56929-30.

12/ *Id.*

the Office to reject the Space E revisions proposed in the NPRM and instead maintain the current SOA forms or even simplify them further.[13/]

Additional Service, Rate and Subscribership Data. The NPRM proposes a modification to Space E under which cable operators would be required to break out additional categories of services and rates and the number of subscribers at each rate.[14/] Although it is not entirely clear, it appears that the Office contemplates that, as revised, Space E would contain rate information reflecting a cable operator's standard rate for each tier of service offered as documented on the operator's published rate card.[15/] As explained, however, the widespread bundled pricing of services and offering of various promotional discounts can and does affect the actual rates paid by individual subscribers for basic cable service. Consequently, complying with the proposed revision to Space E would be quite onerous, with no commensurate benefit. Indeed, the information reported would likely confuse, rather than facilitate, the SOA review, as it would tend to give a highly misleading impression of the operator's actual gross receipts for "the basic service of providing secondary transmissions of primary broadcast transmitters."[16/] Nor could this problem be solved by requiring cable operators to comprehensively report every promotional campaign on the publicly available SOA; such a requirement would run afoul of an operator's legitimate business interest in keeping such proprietary business information confidential.

13/ It is worth noting again that the supposed need to modify the SOA forms to supply owners with additional information has been obviated by the audit process, which allows for a review of much more granular information than could or should be included in a publicly available SOA.

14/ *NPRM*, 82 Fed. Reg. at 56929.

15/ The Office also suggests that information regarding categories of service not be left blank and proposes that operators that do not serve a specific category insert "N/A" or "Zero." However, there is no need to require operators to insert this information rather than leave the field blank. Like these other changes proposed by the Office, this would increase the burden on operators with no additional benefit.

16/ *Id.* at 56927.

Multiple Dwelling Unit (MDU) Rates. The NPRM proposes to require operators to report considerably more detailed MDU subscriber and rate data on Space E of their semi-annual SOAs.[17/] The Office seeks to justify this proposal by suggesting that there is a need to "better organize the type of rate information provided" on Space E.[18/] But because MDU contracts are highly variable, the additional information that the Office would have operators provide would simply increase the time necessary to complete SOA forms without giving either the Office or copyright owners additional insight into the accuracy of an operator's reported gross receipts. It also would force operators to publicly disclose extremely sensitive and closely held competitive information. Instead of requiring cable operators to provide detailed reporting of various bulk categories and rate descriptions, the better option is for the Office to eliminate discrete bulk reporting entirely and treat basic service (including MDU service) as a single "gross receipts" category.[19/]

Changes in Terminology. For reasons that are unclear, the NPRM proposes changing the rate category terminology used in Space E – replacing the terms "service to first set," "service to additional set(s)," and "FM radio (if separate rate)" with the following "more generic categories": "basic service 1," "service 2," and "service 3."[20/] Such changes are unnecessary and would be more confusing than enlightening for the Office, copyright owners and cable operators.

17/ *NPRM*, 82 Fed. Reg. at 56930.

18/ *Id.*

19/ Any required reporting of MDU subscribers should be done on an equivalent billing unit ("EBU") basis, consistent with FCC instructions and industry practice.

20/ *NPRM*, 82 Fed. Reg. at 56930.

C. The Office Should Streamline Its SOA Forms By Eliminating Unnecessary Reporting Obligations.

The changes to the SOA forms discussed above, whether cosmetic or substantive in nature, suffer from a common flaw: cable operators today provide a dizzying array of services, with a wide variety of pricing arrangements. *No* form could practically accommodate the level of detail that would be required to verify the gross receipts reported in Space K. Indeed, the evolution of the cable industry over the past 40 years since the SOA forms were first promulgated militates in favor of the *elimination* of many of the current reporting requirements, not their expansion.

The NPRM itself implicitly acknowledges the SOAs could be improved by reducing the amount of information that operators are required to report, broadly inviting commenters to offer "suggestions on streamlining or otherwise improving reporting practices for the Section 111 license."[21/] NCTA appreciates this invitation and submits that, at minimum, there are two changes that the Office can and should make to the forms to simplify and reduce the costs associated with the reporting process.

First, the Office should eliminate entirely the requirement that operators provide any detail concerning their various rate categories. Specifically, the SOA forms should be revised so that the operator is required to report only: (1) the total amount of reportable "gross receipts" from basic service during the accounting period (*i.e.*, the information that is reported in Space K); and (2) the number of basic service subscribers as of the last day of the period (calculated consistent with the FCC guidance on counting subscribers).[22/] This reporting obligation better

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[21/] *Id.* at 56927.

[22/] *See, e.g.*, FCC Form 325 Instructions; Comments of NCTA, FCC Docket No. 07-269 (filed Feb. 17, 2009) ("For purposes of Commission reporting, cable operators have long used the equivalent billing unit ("EBU") methodology to determine how many bulk rate customers they serve.").

matches Congress's original description of what constitutes the information that a cable operator must report (which did not expressly include any rate information).[23/] The simplified approach to gross receipts reporting described above clearly is preferable to requiring an exhaustive listing of all of the different rate options and promotions that a cable operator may offer during the course of a semi-annual accounting period; as previously discussed, such a listing is pointless given the complexities surrounding promotional pricing and bundled discounts. At the same time, the simplified reporting proposed here would not adversely affect copyright owners: it would provide a straight-forward "revenue per customer" figure that would enable copyright owners to quickly evaluate whether further analysis or an audit is warranted. A simplified reporting requirement also would simplify the Licensing Division's examination of SOA forms, thereby reducing the costs associated with such examinations.

If, notwithstanding the obvious benefits of NCTA's streamlining proposal, the Office is unwilling to eliminate the rate reporting requirement entirely, the Office should at the very least limit the rate information that operators are required to report to a statement of the range of rates on which Space K gross receipts are based.[24/] Moreover, the range of rates that could be reported should not be subject to the types of limitations suggested in the NPRM.[25/] Those limitations would be particularly problematic, since they would result in the disclosure of non-public information and constrain operators' ability to respond to market forces.

Second, another obvious and long overdue step that the Office can and should take is to eliminate in its entirety Space F ("Services Other Than Secondary Transmissions: Rates"). The

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23/ 17 U.S.C. § 111(d)(1)(A).

24/ A requirement to report rate ranges should not require inclusion of short-term promotional discounts in that reported range. These promotions can change rapidly and tracking their availability to various groups of subscribers would impose an extraordinary burden with no corresponding benefit.

25/ *NPRM*, 82 Fed. Reg. at 56929-30.

information required by Space F (and Section 201.17(e)(8) of the Office's rules) does not relate to the provision of secondary transmissions of broadcast service and thus its collection is neither mandated by Section 111(d)(1)(A) of the Act nor relevant to cable operators' payments of royalties pursuant to the compulsory license.[26/] At the time the SOA forms were adopted, the Office's only explanation for why it required reporting of the information specified in Space F was a somewhat vague reference to Section 801(b)(2)(A)(ii), which authorizes adjustments to the Section 111 royalty rates to reflect "changes in the average rates charged cable subscribers for the basic service of providing secondary transmissions."[27/] But because the information called for in Space F has nothing to do with the basic service of providing secondary transmissions, it is unclear how it could play any role in a proceeding brought under Section 801(b)(2)(A)(ii).[28/] Given the burden of recording rate information for every one of the services offered by a modern cable system, including a wide array of non-video services, the Office should take this opportunity to eliminate Space F and make the conforming modifications to its rules.

II. THE OFFICE SHOULD RECOGNIZE GAAP AS THE APPLICABLE STANDARD FOR DETERMINING WHETHER CABLE OPERATORS ARE PROPERLY REPORTING GROSS RECEIPTS.

One of the issues raised in the NPRM that was not raised in the 2005 MPAA Petition – and that has not previously been considered by the Office in any rulemaking proceeding – is how operators should reflect in their gross receipts the amount received from subscribers who purchase a multiple-element "bundle" that includes video as well as Internet and/or voice service for a single set price that is discounted from the aggregate cost of the services that comprise the

26/ *See* 37 C.F.R. § 201.17(e)(8); 17 U.S.C. § 111(d)(1)(A).

27/ *See* 43 Fed. Reg. 958, 960 (Jan. 5, 1978), *citing* 17 U.S.C. §801(b)(2)(A)(ii).

28/ In the more than 40 years since Section 801 was enacted, there has never been a proceeding brought to adjust Section 111 rates based on a change in the average rates charged for basic service.

bundle.[29/] In the NPRM, the Office explains its reasons for addressing this issue, stating that "from time to time, the Office receives questions on how to report the price of cable television in gross receipts on SOAs when it is sold as part of a bundle of services," and asking "whether the Office's regulations should be amended to provide more guidance."[30/] NCTA agrees that clarification of this issue would be helpful, but disagrees strongly with the approach proposed by the Office. The better way to address this issue is for the Office to rely on GAAP.

As the attached Declaration of Professor William Holder explains, GAAP currently provides a methodology, developed over the past two decades, under which the discount applied to a bundled multiple-element arrangement – such as the discounted double play or triple play packages of video and Internet and/or voice offered by many cable operators – is allocated proportionately based on the relative selling prices of the components of the package.[31/] However, despite having incorporated GAAP into its rules implementing other statutory licenses enacted more recently than Section 111, the NPRM makes no mention of GAAP. Instead, the NPRM, without explanation, proposes a revision to the definition of "gross receipts" in Section 201.17(b)(1) of the Office's rules that is both internally inconsistent and at odds with the fundamental structure of Section 111.

Section 111, of course, creates a statutory copyright license only for a cable system's public performance of works embodied in retransmitted broadcast television signals and establishes a royalty methodology that is based only on revenues that cable systems actually receive from subscribers who purchase the tier or tiers containing such retransmitted signals. The current definition of gross receipts codifies this principle by expressly excluding various

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29/ *NPRM*, 82 Fed. Reg. at 56931.

30/ *Id.*

31/ Declaration of Professor William Holder at 3-4 ("Declaration").

other categories of subscriber payments from the revenues on which royalties are based, such as payments for pay-cable, installation, and other non-broadcast services.[32/] Moreover, this principle is reflected in the language of the first clause of the proposed revision to the Office's gross receipts definition:

> In addition, gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service.[33/]

While this language is unassailable, the second clause of the proposed revision is problematic because, on its face, it provides that "gross receipts" must include the undiscounted price that "would have been collected" from a subscriber who purchased cable service as a stand-alone product:

> *instead, when cable services are sold as part of a bundle of other services, gross receipts shall include fees in the amount that would have been collected if such subscribers received cable service as an unbundled stand-alone product*.[34/]

Assuming that the Office intended the result described above, the rule would effectively apportion the entire discount offered to double or triple play customers to the non-video service components of the bundle, resulting in the inclusion of a portion of the revenues attributable to non-video services in the "gross receipts" on which a cable operator bases the royalties it owes for providing retransmissions of broadcast signals. Put another way, it appears that the second clause of the proposed revision is in direct conflict with the first clause. It also would conflict with GAAP.

32/ *See, e.g.*, H. Rep. 94-1476, 94th Cong., 2d Sess. at 96 ("For purposes of computing royalty payments, only receipts for the basic service of providing secondary transmissions of primary broadcast transmitters are to be considered. Other receipts from subscribers, such as those for pay-cable services or installation charges, are not included in gross receipts."); *see also* 37 C.F.R. § 201.17(b)(1); *Cablevision Sys. Dev. Co. v. MPAA*, 836 F.2d 599 (D.C. Cir. 1988).

33/ *NPRM*, 82 Fed. Reg. at 56937.

34/ *Id.* (emphasis added).

Thus, the Office should strike the second clause of the proposed revision to the gross receipts definition. In its place, as it has done in its implementation of other statutory licenses, the Office should recognize GAAP as the appropriate standard for resolving accounting issues that arise in the context of the cable compulsory license.

Embracing GAAP as the appropriate standard will provide clarity. GAAP is the authoritative accounting standard in the United States and the standard applied by cable operators and other companies across the country in order to meet various financial reporting obligations. As Professor Holder states in the attached declaration, GAAP's approach is that "the information provided should faithfully represent the economic substance of transactions."[35/] It is accepted by the SEC, the Financial Accounting Standards Board ("FASB"), and third party auditors.[36/] The Copyright Office itself and the Copyright Royalty Board ("CRB") recognize this and rely on GAAP in analyzing other compulsory licenses.[37/] In line with financial reporting in other contexts, the CRB and the Copyright Office typically rely on GAAP in the statutory

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35/ Declaration, at 7-8.

36/ Other federal agencies that have incorporated GAAP into their rules include the Federal Communications Commission, the Department of Transportation, and the Department of Energy. ***E.g.***, 47 C.F.R. Part 32 (permitting price cap carriers to use GAAP for regulatory accounting purposes); 14 C.F.R. Part 241 (stating that the accounting provisions for certain air carriers are based on GAAP); 10 C.F.R. Part 600 (encouraging certain organizations to use financial management systems complying with GAAP).

37/ Among those licenses are: (1) Physical phonorecords, permanent downloads and ringtones; (2) Interactive streaming and limited downloads; (3) Limited offerings, mixed service bundles, music bundles, paid locker services and purchased content locker services; (4) Nonsubscription services and new subscription services for webcasting; and (5) Preexisting subscription services and preexisting satellite digital audio radio services. *See, e.g.*, 45 Fed. Reg. 79038, 79039 (Nov. 28, 1980); 45 Fed. Reg. 79038, 79040 (Nov. 28, 1980); 77 Fed. Reg. 44179 (July 27, 2012); 79 Fed. Reg. 56190 n. 5 (Sep. 18, 2014).

copyright license context to minimize reporting manipulation and to ensure that revenue-based royalties are calculated in a fair and reasonable manner.[38/]

Of particular relevance to this proceeding, GAAP includes specific guidance related to bundled (commonly referred to as "multiple-element") discounting practices. Professor Holder's Declaration provides detail on GAAP's treatment of such bundling, stating that "the result of the [GAAP allocation] process is to allocate the discount for purchasing multiple services in proportion to the relative selling prices of those services."[39/] As Professor Holder notes, "Not applying a bundled discount to basic cable service sold in a bundled offering along with Internet and voice is inconsistent with GAAP and would, in substance, attribute revenue from other bundled services to the basic cable service."[40/] In addition, many states have expressly adopted the GAAP principle that package discounts are to be allocated proportionately among the package's components.[41/]

Because the Office's proposed rule would treat customers who pay a bundled discount price as if they paid the full *a la carte* rack rate for basic service, it would, as Professor Holder

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[38/] Significantly, in those contexts, none of the authorizing statutes (*i.e.*, Sections 112, 114, and 115 of the Copyright Act) expressly reference GAAP. But the Copyright Office has adopted GAAP as the means to derive "reasonable rates and terms," often at the suggestion of the parties (including copyright owners) to the relevant proceedings.

[39/] Declaration, at 9.

[40/] *Id.* at ¶ 21.

[41/] *See, e.g.*, Cal. Pub. Util. Code § 5860(f) ("Where the holder of a state franchise . . . bundles . . . video services with nonvideo services . . . gross revenues shall be determined based on an equal allocation of the package discount, that is, the total price of the individual classes of service at advertised rates compared to the package price."); Ga. Code § 36-76-2(8)(E) ("Where. . . noncable or nonvideo service is bundled with . . .cable services or video services . . . 'gross revenues' shall include only those revenues that are attributable to cable service or video service . . . . [S]uch revenues shall be allocated in a manner consistent with generally accepted accounting principles."); S.C. Code § 58-12-300(h) ("“Where … noncable service is bundled with the sale of any cable service or services and sold for a single non-itemized price, the term gross revenues shall include only those revenues that are attributable to cable services based on the provider's books and records, such revenues to be allocated in a manner consistent with Generally Accepted Accounting Principles.").

observes, effectively attribute revenue from other bundled services to the basic service tier creating broadcast royalties on revenues that customers do not pay for basic service. To illustrate: Imagine that a cable operator's rate card rate for basic cable, Internet, and voice services is $40 each, when purchased individually, but the triple-play bundle of all three can be purchased for $90, a $30 discount. Under GAAP, this discount would be apportioned pro-rata to all three services, resulting in the attribution of $30 in revenues to each. However, under the Office's proposed revision to the gross receipts definition, it appears that $40 would have to be attributed to basic cable service for purposes of calculating the operator's section 111 royalties and only $25 each to Internet and voice.

This would squarely conflict with Section 111's explicit direction that the statutory royalty payments be based on a percentage of the revenue a cable provider actually receives for basic cable service, rather than for other services.[42/] Indeed, given this stark departure from Section 111's unambiguous mandate, the proposed revision to the gross receipts definition as currently drafted could not withstand a legal challenge under the Administrative Procedure Act.[43/]

The revised definition as drafted would also conflict with the well-settled principle, recognized elsewhere, that revenues from services that are sold together with the basic service are only reportable as gross receipts if the subscriber is required to purchase those other services as a prerequisite to purchasing basic service.[44/] Popular discounted multi-service bundles include

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42/ 17 U.S.C. § 111(d)(1)(B) (directing that royalties be computed "on the basis of specified percentages of the gross receipts from subscribers to the cable services…*for the basic service of providing secondary transmissions of primary broadcast transmitters*"*)* (emphasis added).

43/ *See* 5 U.S.C. § 706(2)(A) (directing courts to "hold unlawful and set aside agency action, findings, and conclusions found to be…not in accordance with law").

44/ *NPRM*, 82 Fed. Reg. at 56930 (noting that "[i]f a tier or other service has no broadcast signals, it need not be reported on Space E").

Internet and voice services to meet fierce competition from national DBS companies, telephone companies, wireline and wireless providers, and Internet-based service providers. Consumers are not required to subscribe to those Internet or voice services to purchase basic cable service. None of the revenues from those non-broadcast services should be, directly or indirectly, conflated with basic service revenue.

GAAP already applies to the revenues collected by cable operators for financial reporting purposes and there is nothing whatsoever in Section 111 or its legislative history that would suggest that Congress wanted operators to deviate from those practices in reporting copyright gross receipts. The Office's proposal appears to be rooted in comments made by the Office in the 1980s in response to some who argued that the tiered marketing and pricing practices of cable operators in connection with their video services opened the door for operators to potentially evade their Section 111 royalty payments. At the time, GAAP did not expressly address this issue. However, GAAP subsequently developed a robust set of principles designed precisely to ensure that accounting for bundled discounts is not manipulated and that such arrangements are instead reported and recorded in a consistent and economically rational manner.

Moreover, the state of competition in today's marketplace moots any concerns that the Office may have had in the 1980s about operators adopting discounting and marketing practices for the purpose of evading royalty payments. Cable operators are not offering multiple-element bundles of video, Internet, and/or voice services in order to minimize copyright payments. Rather, cable operators have created those bundles (and other bundles, such as those that include home security and wireless services) in order to effectively compete in the modern communications marketplace.[45/] Bundled discounts provide benefits not just to the cable operator, but also to consumers and even to copyright owners. Consumers benefit from the additional choices that bundled service offerings provide and the Office's proposal would amount to a copyright penalty on consumers who buy discounted bundles. In the case of copyright owners, the benefit of discounted bundling flows from the fact that as a result of "cord-cutting," many cable operators today have more Internet subscribers than video subscribers. Bundling video with Internet services at a discount helps maintain penetration of the basic service tier.

Departing from GAAP would create unnecessary burdens and risks. Another reason to recognize GAAP as the applicable standard for reporting gross receipts is that not doing so creates unnecessary burdens and risks. Departing from the GAAP "relative selling price" approach would compel cable operators to bear the burden and expense of creating and maintaining a second set of books to track revenues for copyright purposes based on a different set of accounting standards than apply to the rest of a company's financial recordkeeping. This second set of books would be subject to no standard accounting principles and would not be consistent across reporting companies, thus inviting subjective interpretations by different companies and giving rise to inconsistent results in audits and related disputes.[46/]

Accordingly, the only reasonable and appropriate approach to reporting gross receipts in view of the cable industry's widespread and economically rational discounting practices is to

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[45/] *See, e.g.*, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eighteenth Report, 32 FCC Rcd. 568, ¶¶ 51-52 (2017).

[46/] If cable operators are required to use the basic tier "rack rate" in all circumstances, as the Office's proposed rule implies, the result could be the forced reporting of "phantom" revenues in situations where an operator, for example, has a discounted "senior citizen" rate or gives service outage related discounts to subscribers.

allow cable operators to follow the guidance provided by GAAP. By incorporating GAAP, copyright owners would be assured of objective, consistent, predictable, and fair financial reporting free of manipulation.

III. THE OFFICE SHOULD NOT AMEND THE EXISTING "CABLE SYSTEM" DEFINITION.

The NPRM seeks comment on the Office's proposal to add the following new sentence to the definition of the term "cable system" in the rules implementing the Section 111 license: "a provider of broadcast signals must be an inherently localized and closed retransmission medium of limited availability to qualify as a cable system."[47/] According to the NPRM, this change not only reflects the Office's longstanding policy that the Section 111 license applies only to "inherently localized transmission media of limited availability," but also is consistent with the "uniform direction" of judicial precedent regarding the relationship between Internet-based services and compulsory licensing under the Copyright Act.[48/]

NCTA believes that the best course is for the Office to leave unchanged the current language of its rule defining the term "cable system." *First*, the Office's current "cable system" definition essentially tracks the statutory definition.[49/] As such, there is no need to revise the Office's codification of that definition, thereby creating a potentially problematic variation between the statutory and regulatory definitions. *Second*, courts continue to prove themselves well-suited to resolve controversies regarding the application of Section 111 especially as new technologies and business models are introduced.[50/] *Third*, attempting to codify a new statutory

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47/ *NPRM*, 82 Fed. Reg. at 56932.

48/ *Id.* at 56932; *FilmOn v. Windows to the World Communications, Inc.*, 851 F.3d 1002, 1015 (N.D. Ill. 2016); *ABC, Inc. v. Aereo, Inc.*, 134 S.Ct. 2498 (2014).

49/ *Compare* 17 U.S.C. §111(f) *with* 17 C.F.R. §201.17(b)(2).

50/ *See, FilmOn v. Windows to the World Communications, Inc.*, 851 F.3d 1002 (N.D. Ill. 2016). *See also Cartoon Network, LP v. CSC Holdings, Inc.*, 536 F.3d 121 (2d Cir. 2008), cert. denied, 557 U.S. 946

definition in an era of rapid technological change may inadvertently create a new target for the next *Aereo* or *FilmOn* to try to invent around in ways not intended by the Copyright Office; it might even inadvertently thwart the use of new technologies by systems that are unquestionably covered by Section 111. In particular, the terminology used in the Office's proposed revision of the cable system definition – "inherently localized" and "limited availability" – is itself ambiguous, and thus fails to clarify the definition or provide helpful guidance to the courts. Given the ready availability of capable fora to resolve such issues, the Office need not and should not revise the cable system definition.

IV. MISCELLANEOUS PROPOSALS

The NPRM addresses several other proposed revisions, including whether and to what extent operators should report on Space D a cable operator's headend location and county and community information; whether to eliminate references to "Grade B" contours; what, if anything, the rules should say about the impact of interest payments on an operator's exposure to infringement liability; and whether and to what extent operators should be required to make royalty payments via electronic funds transfer ("EFT"). In this section, NCTA briefly addresses these miscellaneous proposals, as well as certain timing issues relating to the implementation of any changes to the SOA forms.

Headend Location and Community Definition. A cable operator currently must identify on its SOA the community or communities served by its system, but is not required to identify

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(2009); *ABC, Inc. v. Aereo, Inc.*, 134 S.Ct. 2498 (2014); *WPIX, Inc. v. ivi, Inc.*, 765 F. Supp. 2d 594 (S.D.N.Y. 2011); *WPIX, Inc. v. ivi, Inc.*, 691 F.3d 275 (2d Cir. 2012); *CBS Broadcasting, Inc. v. FilmOn.com, Inc*., No. 10-cv-07532 (S.D.N.Y. Order to Show Cause for a Preliminary Injunction with Temporary Restraining Order, Nov. 22, 2010); *ABC v. Hang 10 Technologies, Inc.*, No. 3:09-cv-06216-JAP-DEA (D.N.J. 2010); *Twentieth Century Fox Film Corp. v. iCraveTV*, 2000 WL 255989 (W.D. Pa. 2000); *Fox Television Stations, Inc. v. BarryDriller Content Systems PLC*, 915 F. Supp.2d 1138 (C.D. Cal. 2013); *Fox Televisions Stations Inc. v. FilmOn X LLC*, No. 13-758 (D.D.C. 2013).

the system's headend location. In the NPRM, the Office tentatively concludes that it is unclear that headend location reporting, as proposed in the MPAA Petition, would help copyright owners determine whether operators are complying with Section 111(f).[51/] In particular, the NPRM reports that the "artificial fragmentation" of systems that Section 111(f) was intended to address no longer appears to be a pressing concern and, consequently, there is no need to impose the additional burden of headend location reporting on cable operators.[52/] NCTA agrees.[53/]

NCTA also agrees with the Office's tentative conclusion that the definition of the term "community" should not be amended to reflect the operator's "franchise area."[54/] Currently, the Office's rules link a system's "community" for purposes of the Section 111 license to the definition of the term "community unit" in the FCC's rules. NCTA has previously pointed out that equating the term "community" in the Office's rules and the term "community unit" in the FCC's rules was part of a "long-established cable copyright paradigm" and that there is no need to change the definition.[55/] Furthermore, as quoted in the NPRM, NCTA noted in its initial comments on the NOI "that with the advent of statewide franchising in some states, the proposed rule change could result in the artificial joinder of systems."[56/] And state-wide franchising has grown dramatically since 2006.[57/]

51/ *NPRM*, 82 Fed. Reg. at 56932.

52/ *Id.*

53/ *NCTA NOI Comments*, at 8.

54/ *NPRM*, 82 Fed. Reg. at 56933.

55/ *NCTA NOI Comments*, at 10-13.

56/ *NPRM*, 82 Fed. Reg. at 56933.

57/ The National Conference of State Legislatures has compiled a comprehensive list of states that issue state franchises. *See* Statewide Video Franchising Statutes, http://www.ncsl.org/research/telecommunications-and-information-technology/statewide-video-franchising-statutes.aspx.

County Information. The Office concludes that, as proposed by MPAA in 2005, the SOA form should be revised to require cable operators to identify the county where each cable community is located (in addition to the city and state). Although NCTA is generally of the opinion that streamlining the SOA should involve eliminating, rather than adding, new types of information to the form, NCTA did not object to adding county information in 2006[58/] and does not object today.

Grade B Contour References. The NPRM takes notice of the fact that the existing rules contain references to a broadcast station's "Grade B contour" and suggests that such references, which reflect an FCC construct used to measure the signal strength of an analog broadcast signal, may be "obsolete" in light of the transition of broadcasting to digital transmission technology.[59/] Noting further that Congress in 2010 recognized the transition from analog to digital broadcasting by adding a reference to a station's "noise-limited contour" to the "local service area of a primary transmitter" definition in Section 111(f)(4), the Office's response is to propose the elimination of all references to the Grade B contour from its regulations and the SOA forms.[60/]

The Office's proposal, however, is based on a mistaken interpretation of the amendments enacted in 2010. In particular, when Congress added a reference to the noise limited signal contour to the "local service area" definition, it did so with the clear intention of establishing an *additional* basis for classifying a particular signal as local rather than distant. The definition as amended retained its references to the other bases for deeming a signal to be local, including whether a signal is being transmitted to an area that a primary transmitter "*could have* insisted

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58/ *See NCTA NOI Comments*, at 9.

59/ *NPRM*, 82 Fed. Reg. at 56933-34.

60/ *Id.*

upon its signal being retransmitted by a cable system pursuant to the rules, regulations, and authorizations of the Federal Communications Commission in effect on April 15, 1976."[61/] This plainly shows that Congress intended to retain the historical bases for treating a station as local – including the Grade B contour – notwithstanding the broadcast industry's transition to digital transmission technology.

This understanding of the impact of the 2010 amendment adding a reference to the noise limited signal contour to the "local service area" definition is confirmed by the legislative history accompanying that amendment, which shows that Congress did *not* intend for the digital transition to upset settled expectations with regard to the application of the Section 111 to broadcast signals whose status for purposes of the compulsory license has historically been determined by reference to the analog "Grade B contour."[62/] In other words, when Congress *added* a reference to the noise-limited contour to the local service area definition, its objective was not to replace the application of the Grade B contour as a factor in assessing a station's status, but rather to ensure continuity by making the noise-limited contour an additional touchstone for determining a station's status.

A station's post-digital transition noise-limited contour often does not precisely overlap its former Grade B contour – it may be larger, it may be smaller, it may cover areas not within the Grade B or the Grade B may cover areas not within the noise-limited contour. Consequently, the Office's proposal to eliminate all references to Grade B contours could do exactly what Congress was trying to guard against: upset settled expectations.

61/ 17 U.S.C. § 111(f)(4).

62/ H.R. REP. NO. 111-319, at 8 (2009) ("The Committee does not intend for the digital transition to upset settled expectations with regard to the application of Section 111 to broadcast signals whose status for purposes of the compulsory license has historically been determined by reference to the analog 'Grade B contour.'").

Congress has changed the definition of a station's local service area on multiple occasions – and each time the change has been cumulative, effectively grandfathering previous measurements. For example, for many years a station's local service area was determined by reference to FCC rules that defined a station's "must carry" rights primarily in terms of a 35-mile zone, although in some instances the Grade B contour was a factor. Later, when a station's must carry rights were redefined to be coterminous with the station's Designated Market Area, the local service area definition was amended to reflect this change, while retaining the reference to the previous standard.

Congress stated in 2010 that it expected the Office to adopt a "common sense approach" with respect to situations in which the Grade B contour is a factor in the application of the compulsory license.[63/] Such a common sense approach requires the Office to continue to allow operators to rely, as they have in the past, on a station's former Grade B contour so that signals that were local or permitted distant signals in the past based on the Grade B contour do not have their status altered because the noise-limited contour does not overlap some portion of the cable system's service area. In short, the Office should make no changes in its rules to the extent that they refer directly or by reference to a station's Grade B contour.

Interest Payments and Infringement Liability. The NPRM declines to adopt MPAA's suggestion to revise the SOA forms to expressly state that the payment of interest on a late or underpaid royalty submission does not preclude a copyright owner from initiating a copyright infringement claim for failure to timely pay royalty fees.[64/] NCTA agrees with the Office that MPAA's suggested revision should not be adopted. Additionally, NCTA agrees with the Office's proposal to harmonize its interest assessment regulations so that interest begins to

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63/ *Id.*

64/ *See NPRM*, 82 Fed. Reg. at 56935.

accrue on the first day after the SOA filing period for underpayments or late payments and closes and ends on the date the payment is received by the Office.[65/]

EFT Payments. The Office proposes to require payment of supplemental royalty fees and filing fees by electronic fund transfer ("EFT") and eliminate the ability to pay via check or money order.[66/] NCTA does not oppose this technical amendment but suggests that the Office continue to allow waivers of payment via EFT for systems filing on Form 1 and Form 2.

Timing Issues. Finally, the Office should be mindful that the proposals in the NPRM raise timing concerns. Many cable operators have begun using the Office's electronic version of the SOA forms, while a number of others, with the Office's consent, continue to use the "Time Warner Cable Excel Format" SOA forms. If and when the Office adopts and makes effective any of the changes to the SOA forms proposed in the NPRM, it is likely that operators will have to undertake the time-consuming and arduous task of inputting and/or re-inputting a significant amount of data into their electronic form templates. It is critical that operators be given sufficient advance notice to prepare for this eventuality and to carry it out. Thus, NCTA urges the Office to establish an effective date for any changes to its rules and forms adopted in this proceeding that ensures that operators will have sufficient time to transition to the new forms after they are published.

65/ *See id*.

66/ *Id.* at 56936.

CONCLUSION

For the reasons set forth above, most of the changes to the Office's rules and/or forms proposed in the NPRM should not be adopted because they are unnecessary, unduly burdensome, or both. Instead, the Office should seek out and implement changes that simplify the SOA forms in light of current industry conditions. And, as explained above, the Office should abandon its proposed revision to the definition "cable system" in its rules and, in lieu of it proposed revision to the definition of "gross receipts," should adopt GAAP as the applicable accounting standard.

Respectfully submitted,

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Declaration of Professor William Holder

Copyright Office Rulemaking on the Calculation of Gross Receipts for Purposes of Copyright Act Section 111 Cable Compulsory License

I. INTRODUCTORY STATEMENT AND SUMMARY OF OPINION

A. Qualifications

1. I currently serve as Dean of the Leventhal School of Accounting and hold the Alan Casden Dean's Chair of Accountancy at the University of Southern California. During the course of my career, I have taught courses in financial accounting, managerial accounting, auditing, and taxation in undergraduate and graduate programs. I have also published on financial reporting topics including revenue recognition. My published works include the university textbook *Intermediate Accounting*, published by Harcourt, Brace, Jovanovich.
2. Throughout my career, I have served in a number of capacities on governance and standards-setting bodies of the accounting profession, including the Board of Directors (Chair of the Audit Committee) of the American Institute of Certified Public Accountants ("AICPA") and the Accounting Standards Executive Committee ("AcSEC") of the AICPA. AcSEC, a professional body responsible for developing authoritative financial reporting standards, is now known as the Financial Reporting Executive Committee. I also served as a member of the Governmental Accounting Standards Board, a professional body responsible for establishing authoritative financial reporting standards for state and local governments. In particular, my service on these standard setting bodies involved considerations of revenue recognition.
3. I have twice been named as one of the "Top 100 People" in the accounting profession by *Accounting Today*. I also received the Gold Medal for Distinguished Service, the highest honor awarded by the AICPA. I am a Certified Public Accountant in California and Oklahoma.

4. I have served as an expert witness and consultant in a number of trials in state and federal courts, been retained by the U.S. Securities and Exchange Commission and by the U.S. Department of Justice, and provided related trial testimony. In addition, I have consulted with numerous companies, public accounting firms, and government agencies about a variety of accounting and auditing matters. I have addressed revenue recognition issues in connection with my work as a consultant and expert.

B. Description of Assignment

1. I have been retained by NCTA - the Internet & Television Association ("NCTA") in connection with the Copyright Office rulemaking on the calculation of gross receipts for purposes of Copyright Act Section 111 Cable Compulsory License ("Proposed Rule"). I understand that the Copyright Office has invited comments on possible amendments to its regulations related to measuring "gross receipts" when cable operators sell video services, such as the basic service of retransmitting broadcast signals, as part of a bundle of services that also includes Internet and/or phone services.[1]

2. The Copyright Office's Proposed Rule, as currently drafted, requires that, if basic services are bundled together with Internet and/or phone services, gross receipts are to be measured at the amount that would have been collected if such subscribers received cable service as an unbundled stand-alone product:

> … gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service; instead, when cable services are sold as part of a bundle of other services, gross receipts shall include fees in the amount that would have been collected if such subscribers received cable service as an unbundled stand-alone product.[2]

[1] *Statutory Cable, Satellite, and DART License Reporting Practices,* 82 Fed. Reg. 56926, 56936 (Dec. 1, 2017) ("*NPRM*").

[2] *Id*. at 56937. My analysis focuses on the manner in which a discount on bundled goods or services should be attributed to the gross receipts generated by those individual goods or services in conformity with GAAP.

3. I have been asked by NCTA to respond to the Copyright Office's Proposed Rule as an expert in financial accounting and reporting. Specifically, I have been asked to evaluate whether authoritative standards for financial reporting purposes (*i.e.*, Generally Accepted Accounting Principles or "GAAP") provide a methodology that could reasonably be applied to calculate gross receipts for the basic cable service when those services are bundled with Internet and voice services and sold at a discounted price. I have also been asked to address whether the Copyright Office's Proposed Rule is consistent with GAAP's revenue attribution requirements for multiple-element arrangements, such as "bundled" service and product offerings. To the extent that the Copyright Office's Proposed Rule is inconsistent with GAAP, I have been asked to explain the differences between the Proposed Rule and GAAP.

C. Summary of Opinions

Based on my understanding of the facts in this matter and my knowledge of the relevant literature of the accounting profession, it is my opinion that the Proposed Rule's treatment of bundled discounted packages of video, telephony, and Internet services is inconsistent with GAAP and that relying on GAAP will promote the Proposed Rule's objective of ensuring that "gross receipts" reported for purposes of the cable compulsory license will not include any fees collected from subscribers for the sale of Internet or telephony services.

- GAAP is a set of authoritative standards and guidance that is commonly used by business enterprises (including cable operators) for financial reporting purposes. GAAP was developed to provide representationally faithful and neutral (*i.e.*, without bias) information about the economic substance of transactions affecting the reporting enterprise.
- GAAP provides a methodology, largely developed over the past two decades, to allocate revenue in multiple-element arrangements to the individual products and services sold in a bundled offering. That methodology is applied across many industries and circumstances. It could reasonably be applied by cable operators to calculate gross receipts for the basic cable service when those services are

bundled with Internet and/or voice services and sold at a bundled price discounted from the total of their individual stand-alone prices.

- GAAP generally requires allocating discounts among bundled products and services based on the relative selling prices of the products and services otherwise available on an individual, stand-alone basis ("Stand-Alone Selling Prices"). If basic cable service, Internet, and voice are each regularly sold on a stand-alone basis, allocating a bundled discount based on Stand-Alone Selling Prices is representationally faithful and reflects the economic substance of the transaction, which is that all of the services must be purchased in a bundle in order to obtain the discount.
- Contrary to GAAP, the Proposed Rule would attribute *all* of the discount provided to consumers of bundled video, Internet, and voice services to the non-video service components. This would effectively overstate revenue attributed to the video service component and understate revenue from the other components from the perspective of GAAP.
- GAAP results in an allocation that meets the Copyright Office's goal of measuring "gross receipts" from the basic service of retransmitting broadcast signals and its condition that "gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service…."[3]
- Adoption of GAAP as the governing standard for determining a cable operator's reportable gross receipts from basic service also will obviate the need for cable operators to maintain more than one computation of their gross receipts, one consistent with GAAP and one consistent with the Office's rules.

[3] *NPRM*, 82 Fed. Reg. at 56937.

II. DISCUSSION

A. GAAP Is the Authoritative Accounting Standard in the United States

1. GAAP is the authoritative accounting framework in the United States that guides how financial statements are prepared and presented by businesses reporting their financial results.[4] GAAP's objective is to provide information that is decision useful. To accomplish that objective, the information provided should faithfully represent the economic substance of transactions and other events affecting the reporting enterprise. Specific guidance, such as that pertaining to revenue recognition in multiple-element arrangements, is designed to meet the underlying reporting objective to provide financial information that is decision useful.
2. The objectives and fundamental concepts that provide the basis for the development of financial accounting and reporting guidance are outlined in the FASB's conceptual framework for financial accounting and reporting. According to the FASB, "Concepts Statements are intended to serve the public interest by setting the objectives, qualitative characteristics, and other concepts that guide selection of economic phenomena to be recognized and measured for financial reporting and their display in financial statements or related means of communicating information to those who are interested."[5] While the accounting concepts do not directly establish generally accepted accounting standards, they do provide, among other objectives, the FASB with a framework for developing those standards.

[4] About GAAP, Financial Accounting Foundation, http://www.accountingfoundation.org/jsp/Foundation/Page/FAFBridgePage&cid=1176164538898, "The accounting standards developed and established by the Financial Accounting Foundation's (FAF) standard-setting Boards—the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB)—determine how … financial statements are prepared. The standards are known collectively as Generally Accepted Accounting Principles—or GAAP. For all organizations, GAAP is based on established concepts, objectives, standards and conventions that have evolved over time to guide how financial statements are prepared and presented." The FASB's Accounting Standards Codification ("ASC") is the source of authoritative GAAP.

[5] Concepts Statements, Financial Accounting Standards Board, http://www.fasb.org/jsp/FASB/Page/PreCodSectionPage&cid=1176156317989

3. The FASB's conceptual framework for financial reporting identifies several qualitative characteristics of useful financial information. The two fundamental qualitative characteristics are "relevance" and "faithful representation."[6] Information is generally considered relevant if it is capable of making a difference to a user's decision.[7] Faithful representation means that the financial information faithfully represents "the [economic] phenomena that it purports to represent."[8] Faithful representation is also consistent with the notion of reliability and refers to presenting information that is complete, neutral (free from bias), and free from error.[9] Specifically, those concept statements provide:

> A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, deemphasized, or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users. Neutral information does not mean information with no purpose or no influence on behavior. On the contrary, relevant financial information is, by definition, capable of making a difference in users' decisions.[10]

For example, if bundling offers certain subscriber benefits such as price discounts then those discounts should be allocated in a systematic and rational manner that is representationally faithful and neutral (*i.e.*, without bias).

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[6] Concepts Statement No. 8, Conceptual Framework for Financial Reporting Chapter 1, *The Objective of General Purpose Financial Reporting,* and Chapter 3, *Qualitative Characteristics of Useful Financial Information*, QC5, p. 16.

[7] *Id.*, QC6, p. 17.

[8] *Id.*, QC12, p. 18.

[9] *Id*. In addition, the FASB's conceptual framework identifies four enhancing qualitative characteristics. *See, id.*, QC19, p. 19. These include comparability, verifiability, timeliness, and understandability. Information is generally considered more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date (QC20, p. 19-20). Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction faithfully represents the economic phenomena it purports to represent (QC26, p. 20). Timeliness refers to providing information to decision makers in time to be capable of influencing their decisions (QC29, p. 21). Understandability is aided by classifying, characterizing, and presenting information clearly (QC30, p. 21).

[10] *Id.*, QC14, p. 18.

4. U.S. companies issuing financial statements are commonly required to prepare those statements in conformity with GAAP. For example, the SEC requires U.S. companies subject to its registration requirements to issue financial statements that are presented in conformity with GAAP. Moreover, many financing, lending, and partnership agreements, and corporate by-laws require financial reporting in conformity with GAAP. Accordingly, the nation's publicly-traded cable companies currently use GAAP in preparing their financial statements.

B. The Proposed Rule is Inconsistent with GAAP's Treatment of Multiple-Element Arrangements

1. I understand that cable operators offer a variety of products and services to consumers, including those related to video, Internet, and voice. I further understand that, while cable operators regularly sell these products and services individually at stand-alone prices, cable products and services are frequently marketed and sold in discounted multiple-product bundles, such as video and Internet packages (often called "Double Play") and video, Internet, and voice packages (often called "Triple Play"). The prices for bundled products and services are discounted as compared with the price of the various cable products and services if purchased individually from the cable operator.
2. The Copyright Office has acknowledged in its rulemaking notice that cable operators offer bundled discounts. The notice states that cable operators "market video, internet data, and voice services as a single bundle of communications products for a set price."[11] The rulemaking notice further acknowledges that, "subscribers generally pay less for a bundled package than if purchasing each service individually."[12]
3. The marketing practice of providing multiple products or services for a single, bundled price is not unique to the cable industry. This practice follows common marketing and pricing strategies of "buy more, save more" and GAAP provides a

[11] *NPRM*, 82 Fed. Reg. at 56931.

[12] *Id*.

methodology for allocating revenue from the bundled offering (referred to in GAAP as "multiple-element arrangements") to the individual products and services that comprise the bundle.

4. While the basic concept of fair financial reporting has long existed, GAAP standards for multiple-element arrangements became much more detailed in recent years.[13] Detailed discussions began in the 1990s and have become more extensive in an effort to advance the representational faithfulness and decision utility of financial reports. While it is my understanding that in 1988 the Copyright Office issued a "Policy Decision" addressing the reporting of basic receipts with respect to "tie-in" and "discount" arrangements involving tiers of video service, the Office's decision did not, nor could it, take into consideration the relevant GAAP standards for reporting revenues from multiple-element packages developed a decade or more later.[14]

5. According to the most recent clarification of the principles for recognizing revenue from multiple-element arrangements (issued in 2014), the objective of GAAP's allocation process is to "allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer."[15] This objective is aligned with the Copyright Office's condition that "gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service...."[16]

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[13] GAAP for multiple-element arrangements evolved over a number of decades and through a comprehensive process, including the solicitation of viewpoints from a wide range of stakeholders conducted by the FASB, a recognized independent standard setter. Appendix A to this declaration identifies certain accounting standards developed by a number of standard setting bodies over a relatively long period of time, which deal with determining the amount of revenue to be attributed to specific elements of a multiple-element agreement.

[14] *See Notice of Policy Decision, Compulsory License for Cable Systems; Reporting of Gross Receipts*, 53 Fed. Reg. 2493 (Jan. 28, 1988).

[15] FASB, Accounting Standards Codification, 606-10-32-28 (May 2014). *See also* FASB, Accounting Standards Codification, 605-25-05-1 (Nov. 2009).

[16] *NPRM,* 82 Fed. Reg. at 56937.

6. It is important to allocate the consideration to be received from customers generally to each product or service in a multiple-element arrangement. This is particularly true for a business that utilizes marketing practices such as price discounting and bundling. Not applying a bundled discount to basic cable service sold in a bundled offering along with Internet and voice is inconsistent with GAAP and would, in substance, attribute revenue from other bundled services to the basic cable service.
7. The FASB developed a method of allocating consideration received in a multiple-element arrangement based on the relative selling prices of the products or services if regularly sold on an individual, stand-alone basis.[17] The FASB defines "Stand-Alone Selling Price" as "the price at which an entity would sell a promised good or service separately to a customer."[18]
8. The allocation process itself is generally a relatively straightforward calculation based on the relative proportion of each element in the arrangement to the total consideration that is expected to be received. The allocation of revenue to one service in a multiple-element arrangement that also includes other services is equal to the Stand-Alone Selling Price of that service as a percentage of the total Stand-Alone Selling Price of all the bundled services multiplied by the total consideration to be received from the customer. The result of this process is to allocate the discount for purchasing multiple services in proportion to the relative selling prices of each of those services.
9. To illustrate how the GAAP allocation methodology would apply to calculate gross receipts, consider the following example. A hypothetical cable company enters into a contract with a customer to provide basic cable video, Internet, and voice that are sold on a stand-alone basis of $40, $40, and $20 ($100 in total). Assuming that the customer will pay $80 per month for the bundle (representing a

[17] FASB, Accounting Standards Codification, 605-25-25-2(b). "Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices…." *See also* FASB, Accounting Standards Codification, 606-10-05-4(d) and 606-25-32-36.

[18] *Id*., 606-10-32-32.

$20 price discount), the total consideration to be received is allocated based on stand-alone selling prices as shown in Table 1.

Table 1
Hypothetical Example of Calculating Gross Receipts Using GAAP

Service	Stand-Alone Selling Price	Percentage of Total	Allocation of Price Discount	Gross Receipts
	[A]	[B]	[C] = [B]×$20	[D] = [A]-[C]
Basic Video	$40	40%	$8	$32
Internet	$40	40%	$8	$32
Voice	$20	20%	$4	$16
Total	$100	100%	$20	$80

10. In my opinion, the GAAP methodology described above could reasonably be applied by cable operators to calculate gross receipts for the basic cable service when those services are bundled with Internet and voice services and sold at a bundled price discounted from the total of their individual stand-alone prices. Moreover, from an accounting perspective, that methodology is preferable to the proposed rule as a means of reporting gross receipts in a representationally faithful and neutral manner. It is my understanding that the allocation approach set forth in GAAP is generally the approach adopted by cable operators.
11. The GAAP process for allocating gross receipts results in an allocation that meets the Copyright Office's condition that "gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service...."[19]
12. Under the Proposed Rule, even if basic cable service, Internet, and voice are each regularly sold on a stand-alone basis, the bundled discount would only be allocated to Internet and voice. To see the implications of the Proposed Rule, assume, as in the previous example, a hypothetical cable company enters into a contract with a customer to provide basic cable video, Internet, and voice that are sold on a stand-alone basis of $40, $40, and $20 ($100 in total). Assuming that

[19] *NPRM,* 82 Fed. Reg. at 56937.

the customer will pay $80 per month for the bundle (a $20 price discount), the total consideration to be received is allocated based on the Proposed Rule in which none of the discount is applied to the basic cable service (see Table 2).

<u>Table 2</u>
Hypothetical Example of Calculating Gross Receipts Using the Copyright Office's Proposed Rule

Service	Stand-Alone Selling Price	Proportion Based on Proposed Rule	Allocation of Discount	Gross Receipts
	[A]	[B]	[C] = [B]×$20	[D] = [A]-[C]
Basic Video	$40	0%	$0	$40
Internet	$40	100%	$20	$40
Voice	$20			
Total	$100	100%	$20	$80

13. The difference in the calculation of gross receipts using GAAP as compared with the Proposed Rule is summarized in Table 3. Note that the basic cable service receives $8 in additional consideration under the Proposed Rule than under the GAAP allocation methodology by, in essence, including fees collected from subscribers for the sale of Internet services or telephony services that were not included in the allocation method based on GAAP.

<u>Table 3</u>
Hypothetical Example of Calculating Gross Receipts: GAAP vs. Proposed Rule

Service	Stand-Alone Selling Price	Gross Receipts		Difference
		GAAP	Proposed Rule	
		[A]	[B]	[C] = [A]-[B]
Basic Video	$40	$32	$40	($8)
Internet	$40	$48	$40	$8
Voice	$20			
Total	$100	$80	$80	$0

14. Since the economic substance of the transaction is that all of the services must be purchased in a bundle in order to obtain the discount, the Proposed Rule departs from GAAP, which, as previously discussed, was developed to provide representationally faithful and neutral (*i.e.*, without bias) information.

C. Additional Benefits of Adopting GAAP as the Governing Standard for Determining a Cable Operator's Gross Receipts From Basic Service

1. Because the Proposed Rule and GAAP produce different outcomes with respect to the reporting by cable operators of gross receipts from multiple-element discounted bundles of video and Internet and/or voice service, it would put cable operators in the position of having to maintain two sets of inconsistent financial records – one complying with GAAP standards that the operator is obligated to follow by the SEC and by many financial institutions and one complying with the Copyright Office rule.
2. It is my understanding that GAAP has been referenced in rules implementing other statutory licenses under the Copyright Act.[20] Thus, adopting GAAP as the governing standard in the context of the cable compulsory license not only would obviate the need for duplicative, inconsistent recordkeeping, but also would be consistent with past practice.

III. CONCLUSIONS

- GAAP is a set of authoritative standards and guidance that is commonly used by cable operators for financial reporting purposes, relevant portions of which have also been adopted with respect to other statutory licenses under the Copyright Act.
- GAAP provides a neutral methodology to allocate revenue in multiple-element arrangements to the individual products and services sold in a bundled offering that is

[20] *See, e.g.*, 37 CFR 210.12 (applying GAAP to the calculations for the compulsory license to make and distribute phonorecords of nondramatic musical works); 37 CFR 385.13 (applying GAAP to the calculations for determining royalties for subscription and nonsubscription digital music services); 37 CFR 382.11 (applying GAAP to the calculations for determining royalties for SDARS licensees). *See also Compulsory License for Making and Distributing Phonorecords*, Final Regulations, 45 Fed. Reg. 79038, 79039-40 (Nov. 28, 1980); *Mechanical and Digital Phonorecord Delivery Compulsory License*, Final Rule 79 Fed. Reg. 56190, 56191-92, 56193 n. 5 (Sep. 18, 2014).

consistent with the objective of providing information that faithfully represents the economic substance of transactions and other events affecting the reporting enterprise.

- GAAP requires allocating discounts among bundled products and services based on the relative selling prices of the products and services if sold on an individual, stand-alone basis.
- In my opinion, that methodology could reasonably be applied by cable operators to calculate gross receipts for the basic cable service when those services are bundled with Internet and voice services and sold at a bundled price discounted from the total of their individual stand-alone prices. Moreover, from an accounting perspective, that methodology is preferable to the proposed rule as a means of reporting gross receipts in a representationally faithful and neutral manner.
- In my opinion, GAAP results in an allocation that meets the Copyright Office's goal of measuring "gross receipts" from the basic service of transmitting broadcast signals and its condition that "gross receipts shall not include any fees collected from subscribers for the sale of Internet services or telephony services when such services are bundled together with cable service…."[21]

I declare that the foregoing accurately reflects my opinions in this matter.

William W. Holder 10/3/18

William W. Holder　　Date

[21] *NPRM*, 82 Fed. Reg. at 56937.

APPENDIX A

Development of GAAP with Respect to Multiple-Element Arrangements

Year	Standard	Title	Description
1981	AICPA SOP 81-1	*Accounting for Performance of Construction-Type and Certain Production-Type Contracts*	Addressed circumstances under which contracts should be combined or segmented in several elements or phases for purposes of recognizing profits.
1997	AICPA SOP 97-2	*Software Revenue Recognition*	Provided guidance for recognizing revenue in an arrangement that includes multiple elements in the software industry, including that the fee should be allocated to the various elements based on vendor-specific objective evidence ("VSOE") of fair value, regardless of any separate prices stated within the contract for each element.
1999	SEC SAB No. 101	*Revenue Recognition in Financial Statements*	Summarized the SEC Staff's views in applying GAAP guidance on revenue recognition in financial statements, including on multiple deliverables.
2000	FASB EITF 00-21	*Revenue Arrangements with Multiple Deliverables*	Provided guidance to determine how arrangement consideration should be measured, whether an arrangement should be divided into separate units of accounting, and how arrangement consideration should be allocated among the separate units of accounting.
2009	FASB Accounting Standards Update 2009-13	*Revenue Recognition (Topic 605)* *Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force*	Amended revenue allocation guidance to, in part, require that consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The relative selling price method allocated any discount in the arrangement

Year	Standard	Title	Description
			proportionally to each deliverable on the basis of each deliverable's selling price.
2014	FASB Accounting Standards Update 2014-09	*Revenue from Contracts with Customers (Topic 606)*	Clarifies the principles for recognizing revenue. Provides guidance to allocate consideration to each performance obligation in a contract, typically by allocating the transaction price on a relative stand-alone selling price basis.