

**Before the
UNITED STATES COPYRIGHT OFFICE
Washington, D.C.**

In the Matter of:

Mechanical and Digital Phonorecord Delivery
Compulsory License

Docket No. 2012-7

**REPLY COMMENTS OF THE
AMERICAN ASSOCIATION OF INDEPENDENT MUSIC**

The American Association of Independent Music (“A2IM”) provides these Reply Comments to address two issues raised by the Copyright Office’s Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding – treatment of negative reserve balances and identification of third-party distributors.

Background

A2IM is a not-for-profit trade organization that represents over 295 dues-paying independent music labels located across the country that have banded together to advocate for the health of the independent music sector.

Independent record companies play a critical role in assuring the availability to the public of diverse music options and in opening new opportunities for creative expression by artists. They frequently serve as a laboratory for new kinds of music and an entry point into the music business for promising new artists and writers. Sometimes they are the main producers of music in certain genres.

To distribute their products, independent record companies obtain mechanical licenses either by the compulsory process or by voluntary agreements that typically incorporate the

compulsory license terms. Accordingly, A2IM and its members have a significant interest in the outcome of this proceeding.

I. Negative Reserve Balances

A2IM agrees with the initial Comments of the Recording Industry Association of America, Inc. (“RIAA”) concerning the treatment of negative reserve balances. That is, A2IM believes that there is no justification for music publishers to remain in a state of overpayment due to returns for longer than necessary, and that when a publisher has been overpaid due to returns, a negative reserve balance should be recoverable from any other payments to that publisher, certainly where the same writer’s works are involved. Accordingly, A2IM fully supports adoption of the regulatory language concerning this issue that was proposed in RIAA’s initial Comments.

This issue is of particular concern to independent record companies. Compared with major record companies, small and medium record companies invest in the creation of sound recordings by a higher proportion of newer and unproven or less established artists. Consumer demand for their music, and particularly for physical copies of their music, is very unpredictable. This can result in high physical product return rates, even if there is ultimately a high digital sales volume.

When the physical product return rate is high, the inventory obsolescence/destruction costs, return processing and accounting costs, and marketing costs that were not recovered can be a significant financial burden on a small or medium record company. Being required to continue to pay mechanical royalties on new digital sales while the music publisher is holding an overpayment of mechanical royalties on physical products could create a significant financial hardship for a small or medium record company.

However, that is precisely the result that the music publisher and songwriter groups seek when they argue that a negative reserve balance should not be recoverable by offsetting digital royalties. The music publisher and songwriter groups make various arguments to support their position, but they never addresses the fundamental unfairness of requiring small and medium record companies to continue to make payments to a publisher who owes money to the record company due to returns.

One of their arguments – that it is necessary to maintain incentives against “over-shipping” – is particularly unfair. No independent record company ships physical products to distributors without a genuine hope that those products have been finally sold and will not be returned in substantial numbers. However, when one is investing in the careers of unproven or less established artists, sadly, returns are not an uncommon occurrence. Over-shipment is not a bad business practice that needs to be discouraged. It is simply the unfortunate result of an artist about whom both the record company and publisher were excited not finding as much consumer acceptance as we all hoped. When that happens, the music publisher should not enjoy the windfall represented by holding the overpayment corresponding to the negative reserve balance, while the record company is punished by having to continue to pay mechanical royalties on a current basis for digital sales.

II. Identification of Third-Party Services

A2IM also agrees with RIAA’s position concerning identification of third-party services distributing cents rate digital phonorecord deliveries (downloads and ringtones).

Small and medium record companies often simply may not have this information, if their digital distribution is handled through an aggregator. Even if they have or could obtain this information, a requirement to report such usage by service would dramatically increase the

label's administration burden. Small and medium record companies have only limited administrative and financial resources. Increasing the reporting burden as proposed by the music publisher and songwriter groups will either result in financial hardship, or non-compliance, or resources being diverted from the creation and promotion of new music. All of those results are undesirable, and the publisher and songwriter groups provide no justification that would warrant such results.

CONCLUSION

For the reasons set forth above, A2IM requests that the Office confirm that negative reserve balances can be recovered from royalties for DPDs and broadly from payments to the copyright owner. A2IM also requests that the Office not require reporting of distributors of cents rate digital phonorecord deliveries.

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Respectfully submitted,

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