

Testimony of

Ish Cuebas

Director of Merchandising Operations
Trans World Entertainment and Co-Chairman of the Media on Demand Task Force Corporate Circle
July 12, 2005

Testimony of Ismael Cuebas
Director of Merchandising Operations
Trans World Entertainment Corporation
on behalf of the
National Association of Recording Merchandisers (NARM)
Before the Subcommittee on Intellectual Property
U.S. Senate Committee on the Judiciary
"Music Licensing Reform"

Tuesday, July 12, 2005

Good morning, Chairman Hatch, Ranking Member Leahy and members of the Subcommittee. Thank you for inviting me to testify today about the current and future profile of music retailing, the related challenges in music licensing and how Congress can help our industry now so it can remain healthy and vibrant. I am Ismael Cuebas, Director of Merchandising Operations for Trans World Entertainment Corporation in Albany, New York. I have held this position since 2001. Prior to that, I was a music buyer for Trans World, a position I assumed in 1994. I currently serve as a liaison between my company's Merchandising, Marketing and MIS Departments. My individual affiliations with NARM include serving on NARM's Media-On-Demand Task Force and Retailers Advisory Council.

Trans World is a member of the National Association of Recording Merchandisers (NARM). Founded in 1958, NARM is an industry trade group that serves the music retailing community. NARM's diverse membership includes brick-and-mortar, "click-and-mortar" and online retailers, wholesalers, distributors, content suppliers (primarily major and independent music labels, but also video and video game suppliers); suppliers of related products and services; artist managers; and consultants, marketers, and educators in the music business field. The Association's retail/wholesale membership alone represents about 25,000 stores and 500,000 employees.

NARM represents about 85 percent of the music and entertainment retailing marketplace, from Anderson Merchandisers and Handleman Company (Wal-Mart and Kmart wholesalers), Best Buy, Borders, Circuit City, Musicland, Newbury Comics, Target, Tower, and Virgin to "tastemaker" independent retail coalitions and smaller individual specialty stores. Our members also include online retailers like Amazon.com, eBay and Apple Computer's iTunes Music Store, as well as new players in the industry such as Starbucks.

Trans World is one of the largest entertainment retailers in the United States. Founded in 1972, the company currently operates over 800 stores in 46 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Trans World operates e-commerce sites including fye.com, warehouse.com, coconuts.com and secondspin.com.

Trans World's mall locations operate primarily under the FYE--For Your Entertainment brand. The Company also operates freestanding locations under the names Coconuts Music and Movies, Strawberries Music, Warehouse Entertainment, CD World, Spec's, and Planet Music.

Trans World launched the FYE Download Zone--a subscription based digital music subscription and download service--in October 2004. The FYE Download Zone increases the functionality and catalog available for our customers to sample and purchase the music they want. Over 1 million tracks can be accessed via permanent downloads, portable subscriptions or tethered subscriptions and streaming.

Trans World is also designing and developing the next generation of our innovative listening and viewing stations (LVS) called LVS 3. This is a next generation of technology for our customers, which will enhance their overall in-store experience and expand our sales opportunities through new product information displays and full catalog search capabilities.

LVS 3 is more than a device and an improved set of information; it's a whole new technology platform being designed and built to support the growing business of digital media whether burning a CD, delivering digital music to the home, or filling a portable player in the store. Available later this year, LVS 3 will be a destination within a destination--a place in our stores where customers can view promotions, search and browse our full product catalog, place special orders for product not in the store and select digital music in the manner of their choosing.

As the digital media industry grows, our LVS 3 system will grow with it. We are building a new system for the needs of today and laying the foundation for the needs of tomorrow. For Trans World and its retail contemporaries, tomorrow is here. If this business model is to progress as we all hope it will--and feel there is certainly the strong potential to develop--Trans World will want to have the licensing process be expedited and as seamless as possible. I will explain later in this testimony the obstacles we face in accomplishing this objective.

Music retailers continue to face significant business challenges. A year ago this month, CD sales were ahead of 2003 by about 9 percent. By the end of 2004, that lead had dropped to about 2 percent, but still provided the first positive numbers since 2000. So far this year, however, it has been a decidedly different story. At mid-year, CD album sales have fallen behind 2004 by approximately 7 percent, which is cause for some concern. But historically, the fourth quarter presents some of the year's highest profile artists and album releases, and accounts for a big portion of annual sales.

On the other hand, sales of digital tracks continue to post huge increases year-over-year and offer promise for bright prospects for the entire industry. Consumer demand is clearly there for digital music delivery, fueling increasing interest among music retailers to explore ways they can sell more music to more people in their stores using various new digital delivery models.

We know that one of the best ways to reduce the demand for pirated digital downloads is to provide consumers with the opportunity to avail themselves of a broad range of exciting, legal alternative products and services--both in retail stores and online. We want to help the industry sell more music to more people.

This is no small challenge and time is definitely not on our side. With this in mind, NARM has been working with its content distributor, kiosk and related technology vendor members, as well as the Recording Industry Association of America (RIAA), to develop in-store options to serve music consumers and add more excitement to the music shopping experience.

Retailers are excited about the prospect of introducing these new offerings in their stores to meet the demands of consumers. Options may include downloading full albums onto a burned CD or portable device; compiling multiple songs onto a custom burned CD or portable device; downloading songs on demand to a portable device; or even downloading songs in the store and sending them to a home or office computer.

Some of the other ideas being talked about include having "just in time" delivery of a sound recording so that a store is always "stocked" and retailers don't lose sales opportunities; and offering out of print recordings or recordings that

appeal to niche audiences that stores don't carry because there isn't sufficient space to support demand. Even more exciting is the opportunity to provide consumers with one-of-a-kind, special products like limited distribution of a live concert within days of the performance.

NARM is uniquely positioned to help advance the industry's efforts to explore the commercial viability of this new technology because its constituents come not just from the retail/wholesale segment, but also from the record label and kiosk/technology communities. NARM is trying to balance the interests of each.

In March 2004, NARM formed a Media-On-Demand Task Force comprised of prominent retailers conducting beta testing of in-store CD burning kiosks. The Task Force spent months sharing experiences and gathering information from retailers, record labels and CD burning technology companies. In February 2005, the Task Force gathered almost 50 representatives from the technology, computer hardware, content and retail communities.

This first meeting was noteworthy because it exemplified a willingness of competitors and trading partners to exchange issues and concerns about how to make this new technology suitable for retailers. The successful meeting concluded with a shared commitment by all participants to get actively and quickly engaged in seeking solutions to shared challenges.

After careful analysis and exchanging specific concerns with the content and technology companies, the Task Force held their second meeting in June 2005 to explore further how retailers can compete with "free" by creating a compelling value proposition for consumers.

Buoyed by business opportunities to increase special order sales, Task Force members are nevertheless concerned with the slow progress being made in the amount of content available for burning. Whether it's full-length albums or single tracks, the quantity of music that retailers currently have to offer their customers for lawful burning is discouraging.

A significant amount of music is still unlicensed, largely because of the extraordinarily burdensome process that is required. While we are actively working through a myriad of other key issues that need to be addressed as well, clearly the burdens of the music licensing process have surfaced time and time again as an impediment to advancing these business models. Our record label partners are trying to ramp up to handle the convoluted licensing process, but that takes time--time we simply do not have.

In order to support these digital delivery initiatives, we need to modernize the Section 115 license. The Section 115 mechanical license was created at a time and for a technology that doesn't fit with today's new digital technologies.

The license also requires that a royalty be paid on any copy of a sound recording, however many "copies" are made in the process of producing digital downloads or in streaming. These copies are not actually publicly performed in the traditional sense. The statute makes no distinction between ephemeral copies and other copies.

Additionally, the development of new technologies to deliver music to consumers has raised questions about whether some new products and services implicate purely mechanical licenses, performance licenses or some combination of the two. Attempts to resolve these matters through private negotiations is a time-consuming process ill-suited to the pace of the technological progress in the music industry and has made it virtually impossible for retailers to keep up with consumer demand for legal alternatives to file sharing services.

As this Subcommittee is probably aware, a number of proposals have been offered in the past few months by the various parties involved in the debate over modernization of the Section 115 license. I will take a few moments to comment on these proposals from the NARM perspective.

NARM, together with RIAA and the Recording Artists Coalition (RAC) have strongly advocated a broad blanket license that would cover all technologies and speed up the licensing process. In our view, retailers have a brief window of opportunity in which to launch digital services and capitalize on the growing acceptance and demand for music in a variety of digital formats.

NARM has applauded various proposals for a new blanket license to facilitate easier clearance of copyrights and has pledged to work with everyone involved in the music industry to find an acceptable compromise. While the parties have worked hard to reach a compromise and we have found much common ground, the principal issue for retailers is that Section 115 be modernized to ease the burden of licensing and that it cover all products in the marketplace.

The current Unilicense proposal being suggested by the performing rights organizations, music publishers and songwriters, does not meet our test as it is too narrow in its scope. The NMPA/PRO/Songwriters proposal applies only to "time-based subscription fee" services. While some retailers may choose to offer subscription services, others are considering alternative digital distribution configurations that will not be subscription-based. Some may do both.

The Copyright Office's proposal would offer broader blanket licensing for the distribution of phonorecords, but unfortunately, the administrative process resulting from eliminating the compulsory license altogether would likely create more uncertainty, and add new levels of complexity, that could actually make things worse instead of better for music retailers.

These proposals also do not address the new generation of physical products like DualDiscs, that have been embraced by consumers and present an encouraging beacon of hope for the bottom line of "brick-and-mortar" music retailing. This new product is a single disc that includes a CD on one side and an enhanced audio version of that CD, plus video content on the other side.

The music industry needs a vehicle to attract the consumer by offering an exciting value proposition. NARM believes that this is DualDisc. Under the current system, for example, it could take more than 100 separate licenses to clear one DualDisc, which is hindering a more robust release schedule.

Conclusion

NARM supports converting the existing Section 115 license into a blanket license that will cover all products in the marketplace. Based on the what we've learned from our Media-On-Demand Task Force, we believe it's the only way to get licenses cleared quickly and not be embroiled in protracted negotiations. What our retailer members have told us loud and clear is that they need the opportunity to experiment with various digital distribution models over the next few years. Experimentation is critical because it is the key to identifying what kinds of products consumers will want.

Legal digital download services represent a significant anti-piracy initiative and are a great opportunity for songwriters, publishers, record labels, retailers, and digital service providers to sell more music and generate excitement and enthusiasm among music consumers -- a goal everyone in the music industry shares. This opportunity will be missed if retailers can't easily experiment with the whole range of models for providing music on demand.

NARM continues to advocate for a legislative solution that will provide for a broad blanket license with a simplified administrative process so our members may get even with, or ahead of the curve instead of remaining behind it. We are committed to moving forward with both one-to-one and group negotiations, and look forward to working with you and your staff to help resolve these important issues.

I thank the Committee for this opportunity and ask that my written testimony be made part of the record.