Sharing Still Divisive

A new website makes it easy for music fans to trade actual CDs by mail. Recording executives say the operation enables piracy and could hurt sales.

By Charles Duhigg, Times Staff Writer
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Depending on whom you ask, Lala.com — a new website that helps song lovers trade entire compact discs for less than the cost of a single iTunes video download — is either the music industry's salvation or yet another nail in its coffin.

Those in the pro-Lala camp like to tell the story of its founder, Bill Nguyen, a Silicon Valley wunderkind who sold a previous start-up for $850 million and set out to use some of the proceeds to help music aficionados like himself discover new tunes. He and a few superstar programmers spent a year and more than $1 million designing an online community where users can list the CDs they own and those they want.

Lala.com, which was launched last month, pairs those who want with those who have and facilitates a trade, collecting $1.49 per disc.

That fee doesn't quite cover Lala.com's costs. But executives think that eventually the company will earn big profits, both by selling CDs at retail prices and by selling the demographic details it gathers about its users to record labels.

"If we know what CDs you keep and don't keep, we can spur purchases of new albums," said Michael Krupka, a Lala.com board member and a managing director at Bain Capital, which along with Ignition Partners invested $9 million in the start-up. "The more we know about you, the more effectively we can encourage you to buy."

But those who subscribe to the anti-Lala viewpoint, many of them music executives, say Lala.com is nothing more than quasi-legalized piracy.

"This is a nudge-nudge, wink-wink way to get around the law," said Ted Cohen, senior vice president of digital development at EMI Music. "It makes it easier for people to copy CDs and steal music. Why would the music industry do anything to encourage a company like this?"

Cohen and others like him shudder when they hear Lala's goal of attracting at least 2.5 million regular users within the company's first two years.

Currently, Lala.com's fewer than 100,000 members each trade about 3 to 4 discs a month. At that rate, if the service really catches on, its users could trade more than 120 million albums a year. That's equivalent to almost 20% of the CDs sold in the United States in 2005. Some music executives worry that such a success for Lala.com would cause a drop in sales of new albums.

Since its launch, the website has generated enormous buzz. Its slick design and easy-to-use interface make it easy to trade CDs. Users can also upload photos, blog about their lives and discover online friends with similar musical tastes.

Laura Hicks, a 32-year-old student teacher in Northern California, learned about Lala.com from a radio program last month and has received and sent more than 90 CDs since then.

"It's so easy and cheap to get new CDs that I don't even bother to copy them onto my
“Sometimes I'll get four discs a day. It's like rediscovering music.”

Lala.com examines users' profiles and iTunes libraries to recommend new albums. If a listener agrees with the website's suggestion, or requests a different disc, Lala.com will find someone who wants to trade that CD. In return, the listener pays only $1 to the website and 49 cents for postage, and promises to eventually mail a disc from his or her own library to someone else.

Because Lala.com never handles the CDs — the company merely supplies addresses and shipping envelopes — it has minimal overhead.

Despite that, Lala.com loses money on every trade — a fact that won't change no matter how many users it attracts. But executives hope that when demand for a popular CD outpaces the supply of folks willing to trade it, users will opt to buy a new version of the album from the site's online store. Selling new CDs and digital downloads, Nguyen expects, will help him turn Lala.com into a company worth more than $300 million.

The key to Nguyen's vision is the belief that trading used CDs is legal, unlike peer-to-peer networks where users swap copies of digital songs. Indeed, although the law is a little murky, the courts have generally decreed that it is legal to buy, sell or trade used tapes and compact discs, as long as they are not copies and the transaction is not a rental.

To make sure all trades are above board, Lala.com asks members to report when they receive copied CDs. The company pledges to remove from the system anyone caught sending non-original discs.

But because the company never actually takes possession of the traded albums, it can't guarantee that pirated discs won't be exchanged. And although the website asks members to remove songs from their computers after mailing the CD to someone else, there's nothing to prevent a Lala.com user from receiving a CD, copying it, and then trading the original again.

That's what worries the music executives whom Lala.com hopes to woo into partnerships.

At a conference last August, the chief executive of the Recording Industry Assn. of America, Mitch Bainwol, told a room full of music retailers that "listeners who make copies of CDs and give them to friends are becoming a greater threat than peer-to-peer networks." Bainwol added that one reason for the industry's downturn is that 12% of U.S. households regularly copy CDs for acquaintances who might otherwise buy a new version of the album.

"We care about music," Nguyen said. "We want to show the industry that we're the kind of partners they want to do business with."

But executives at all the major record companies say they are nowhere near a deal with Lala.com. Privately, some executives say they can't imagine ever partnering with such a site.

Four decades ago, before courts ruled that selling used recordings was legal, the music industry tried to stop stores from offering pre-owned tapes and records. Today, many music executives believe that trading of CDs decreases the industry's profits. When someone who really wants Aerosmith's "Pump" gets it in a trade, the argument goes, the band and its label lose a sale.

Nguyen has an answer to that. He has promised that 20% of the money collected by Lala.com on traded albums — or about 20 cents per disc — will go to artists. The company hopes musicians, who receive not a penny when a music retailer sells a used CD, will hype the site among fans. (Managers of artists, however, point out that when a new album is purchased, many artists get much more than 20 cents.)

Nguyen, who named Lala.com after the first sounds spoken by his son, is accustomed to overcoming daunting odds. He previously helped build six start-ups, including mobile e-mail company Seven and software firms Onebox and Tioga Systems. Altogether, Nguyen has helped create companies valued at more than $2 billion, he says.

Lala.com got a huge boost last June when eBay engineer Anselm Baird-Smith rebuffed an offer from Google to work with Nguyen — a hire so blockbuster it was mentioned on the front page of the Wall Street Journal.

Ultimately, Nguyen says, Lala.com can succeed even if record companies rebuff its
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"We already have deals with distributors to sell new music over the site," said Nguyen. "We would prefer to work directly with the labels, but if they refuse, it's still against the law for them to prevent us from selling their new CDs or digital downloads."

Krupka, the Lala.com board member, agrees. He says the music labels, hurting from sales declines and desperate to break Apple Computer Inc.’s hold over the digital download market, may be in no position to dicker.

"People can already buy second-hand CDs on eBay or in music stores," Krupka said. "At the end of the day labels want to sell music. The information we are collecting will help them sell more albums. They'll come around."