The Man Who Hijacked Napster

Shawn Fanning was the brains behind the popular Internet startup, but it was his uncle, John Fanning of Hull, who called the shots - and pocketed an estimated $1 million before the business went bankrupt.

By Joseph Menn, 4/20/2003

Instead of feeling relieved, Napster Inc. chief executive officer Eileen Richardson was pacing the halls with worry. San Francisco’s Hummer Winblad Venture Partners had committed to invest $13 million for a minority stake in the hugely popular Internet music company, giving Napster an official worth of $65 million. The infusion would come just in time: With no revenue and mounting bills from the record industry’s federal lawsuit, it was either Hummer Winblad’s money
or no paychecks for the staff. And Napster’s three board members had backed the deal – Richardson, in her first CEO job; Yosi Amram, Napster’s first equity investor; and John Fanning, uncle of Napster’s inventor, teenage hacking hero Shawn Fanning.

But Richardson needed John Fanning’s signature on the documents, and she didn’t know where he was. Quite possibly, the elder Fanning was trying to cut a deal with someone else, potentially wrecking Napster’s best chance for survival. Richardson grabbed 19-year-old Shawn and his Napster cofounder, Sean Parker, also 19, and propelled them toward a tiny conference room. “Find your uncle!” she yelled.

Before they started phoning around, the two agreed to tell John Fanning that he would prove himself a visionary by accepting the Hummer deal. And they would stress that unlike conditions in previous offers that he had vetoed, John Fanning could stay on the board. “We had to convince him that he was a seasoned entrepreneur and a respected, benevolent leader,” Parker recalls. “At the same time, we somehow had to get his subconscious to understand he would be missing out on the money if he didn’t do it.” Shawn got his uncle on the line, the blood pounding in his ears. “We just tried to convince him,” Shawn says. At last, John Fanning succumbed.

Shawn had good reason to be happy that night in May 2000, beyond the new money and his residual pride in creating the fastest-growing business of all time. Certainly it helped that Napster’s new interim CEO, Hummer Winblad partner Hank Barry, was a longtime lawyer who thought Napster would defeat the record labels’ claims that Napster was helping millions of people evade copyright laws. But one of the biggest reasons was that Shawn believed his combative 35-year-old uncle would finally be receding into the distance. Most people assumed that Shawn controlled the company that bore his childhood nickname, but in fact his little-known uncle had been calling the shots from the start. John Fanning was the closest thing to a father that Shawn had. But the elder
Fanning had made some terrible calls, behind the scenes, as the press was turning the soft-spoken Shawn into a generational icon.

Coleen Cerrier, John Fanning’s older sister, raised her son Shawn by herself at first, then with a truck-driving husband who gave her four more children. They lived near Brockton’s housing projects for a time, and Verrier could see her already-shy son withdrawing from the urban turmoil around him. “He went inside himself real deep and said, ‘I want to get out of this.’ Even though it meant losing him a little bit, it’s what I wanted for him,” says Verrier, then working as a nurse’s aide. As Shawn grew, Verrier turned to her business-minded brother, John, to help guide her son. John Fanning gave him money for each A he brought home from school, and he bought him an Apple Macintosh computer that Verrier could never have afforded.

Shawn worked summers in Hull at John Fanning’s Internet company, Chess.net, often sleeping on the couch. “I was just getting into programming, so I spent a lot of my time just fiddling with projects and hanging out,” Shawn says. It was also then that Shawn discovered what would make him famous: MP3 digital music files.

After graduating from Harwich High School in 1998, Shawn enrolled at Northeastern University. His freshman roommate complained that there was no easy way to find MP3s on the Net. Lycos and other indexes were often out of date, leaving dead links where the music had been. Shawn figured that there should be a way to combine the breadth of search engines like Google with the “presence awareness” of systems like instant messaging, which know who is signed on at any given time. And by having all users store their music on their own computers, the electronic pipes wouldn’t clog – not if the new system just connected a pair of people and then dropped its own connection to them.

When Shawn had something ready for testing, word leaked out, and soon hundreds of kids were swapping music. Chess.net friend Tarek Loubani says he has seldom seen anyone so focused: “I don’t think people can appreciate how hard he worked.”
John Fanning bears little physical resemblance to his solidly built and nearly-shaven-head nephew, sporting thinning brown hair and a bantamlike forward stance. He graduated from vocational high school in Hanover in 1982 and took courses at Boston College on and off for eight years without graduating. He wanted to be a contractor and worked in construction. A stint at Boston-based Fidelity Investments sounded better. Fanning, who declined to be interviewed, says through an attorney that he worked there as a “senior trader,” handling high-risk investments. He also spent time in Fidelity’s “telecommunications group,” which the lawyer says dealt with holdings in the telecommunications industry.

Fidelity says something different. According to spokesman Vincent Loporchio, Fanning worked as a console representative for two years. Console representatives do not make trades. “They are responsible,” Loporchio says, “for watching customer call volume and routing customer calls appropriately.”

In the early 1990s, John Fanning bought a struggling computer business on credit, and it failed after two years. His next try at business began with his love of chess. A staff of Carnegie Mellon University graduates got small equity stakes in Chess.net, with Fanning keeping majority control of the online games firm. Fanning’s dominant position was “an invitation to disaster,” says software engineer Brian McBarron. Coworker Matt Ramme says the team was too inexperienced to know that the balance of power should have been different; the staff had initially been overly influenced by what they thought was Fanning’s past success. “We were working for free, essentially,” Ramme says.

John Fanning did some things right, including making a deal for referrals from America Online that brought in thousands of online chess players. The internal management was another story. The programmers soon discovered that the office rent and other bills were going unpaid, and even paychecks were erratic. Numerous lawsuits from the late 1990s show that Fanning’s troubles extended beyond Chess.net. He lost two default judgments totaling about $44,000 for bad debts in 1999, and he was charged with assault with a deadly weapon after he attacked a maintenance man at his Hull condominium complex. Fanning later got the default
judgments vacated on the grounds that the creditors had his address wrong. The assault charge was dismissed after Fanning completed pretrial probation.

In January 1999, Shawn dropped out of college to concentrate on writing the program that would become Napster. In May, John Fanning filed papers incorporating the company. At first, Shawn was pleased by his uncle's participation. But then John Fanning told Shawn that he would be getting only 30 percent of the company: John Fanning would keep the rest. Fanning explained to his stunned nephew that the company needed an experienced businessman like himself in charge. Besides, when it came time to sell part of the company to new investors, John Fanning said, he would unload some of his shares, reducing his percentage of the company. Less emphasized was the obvious corollary: that Fanning would be the first to get money out of the project to which his nephew was devoting every waking hour.

Shawn signed the paper that his uncle gave him. At a gym one day with Loubani not long afterward, Shawn talked about how he could try to wrest more of Napster back from his uncle. But he didn’t see a way. “He never forgot that it was his uncle that did this to him,” Loubani says. “From then on, the relationship became really strained.” Always guarded about personal matters, Shawn has declined to criticize his uncle's actions in public. But there is unanimity in Shawn’s circle about his real feelings. “He regrets that – giving so much control away,” his mother says.

Napster needed money to pay for computers as more people tried to sign on. Shawn told his friend Sean Parker about the project. Parker, who had met Shawn earlier online, was a budding entrepreneur with a wide range of technology contacts in his native northern Virginia. In the spring of 1999, Parker called his friend Ben Lilienthal, who had just sold an e-mail firm to Andover-based CMGI, an Internet holding company. “There was no question in my mind it was going to be huge,” Lilienthal says of Napster. “There was just a question of: Was it going to be legitimate.” Lilienthal told one of his previous backers, New York investor Jason Grosfeld, what he knew. Grosfeld said that if Lilienthal believed in Napster enough to run it, he would put up the seed money.

Within a week, Lilienthal and Grosfeld came to Napster’s office in Hull. Fast-food containers littered the place.
John Fanning was wearing black Reeboks and pink Bermuda shorts. In the back was what appeared to be a card table, where Shawn was working on his laptop. Lilienthal and Grosfeld took turns talking seriously with Shawn while the other occupied John Fanning. “We sat there and listened to how impressed this guy was with himself,” Grosfeld says. “All I wanted to do was talk to the kid.” When it was Grosfeld’s turn to occupy the uncle, John Fanning started peeling through a stack of business cards on his desk, bragging about his contacts. Among the cards, he said, was that of Ben Rosen, a powerful venture capitalist who initially funded Compaq Computer Corp. Grosfeld smiled appreciatively. “If Ben Rosen knows this putz, I’ll eat my hat,” he thought.

Lilienthal and Grosfeld hired lawyers to research cases against companies that profited from others’ copyright infringement, and they turned up a disaster in the making. The common threads in the court cases and in the Digital Millennium Copyright Act of 1998 were knowledge of wrongdoing and the ability to stop it. Unlike an Internet service provider that doesn’t know who is posting what, Napster always knew who had what file and to whom they were transmitting it. “They were not in reality closing their eyes to the copyright infringement going on there – they bragged about it,” Grosfeld says. “My lawyer thought it was insane.”

Lilienthal and Grosfeld knew that Napster’s technology was both legal and a dramatic leap forward. So they debated simply licensing the file-swapping technique to other companies. The possibilities seemed real enough, but the men didn’t trust John Fanning to follow them down that road. Lilienthal decided that if he were going to try to steer Napster out of its predicament, he needed to make sure Fanning wasn’t in control. During weeks of negotiations in the summer of 1999, Lilienthal and Grosfeld offered John Fanning as much as $1 million to whittle his stake down to about a third. They got as close as 2 percentage points apart on what Fanning’s remaining equity would be. Then, without warning, Fanning would change the conversation. “How much do you have?” he asked Grosfeld at one point. “How much could you wire me today?” The pair ultimately realized that Fanning would never sign.

Similar dramas played out with two other sets of
investors. In both cases, John Fanning wouldn’t give up majority ownership of Napster. But Fanning finally found someone willing to deal on his terms: old chess partner Yosi Amram, the founder of Individual Inc., which delivered news tailored to personal tastes. Amram did nowhere near as much research into the issues as others had. “I liked the idea, and it was getting some traction,” Amram says. “I made a quick decision.”

He put $250,000 into Napster over Labor Day weekend in 1999 and set three conditions. First, John Fanning couldn’t be the CEO; Amram would make that pick. Second, Amram and the CEO would be two-thirds of the board, with the ability to outvote Fanning if need be. And third, Napster would move near Amram’s home in northern California, so he could keep an eye on it. Former venture capitalist Eileen Richardson soon presented herself as a potential CEO; without meeting John Fanning, she told Amram she wanted in.

The ragtag crew threw together a strategy that was significantly undercooked. One of the first planning documents, from early October 1999, was discovered in litigation but kept out of the public court file. It proposed a strategy that comes close to a dictionary definition of extortion. By exploiting the obvious Napster advantage – “users know that by connecting to Napster, they have access to any music they want, absolutely free” – the unidentified authors explained that they could force the record industry to negotiate in order to reach Napster’s audience. “The fact that we grow to 4 or 5 million simultaneous users with millions of songs (through the inherently viral nature of the Napster concept) can hardly be ignored by Sony or EMI,” the document stated. Deliberately staying under the media’s radar, Napster lasted three months before the five major record labels sued in December 1999, putting Napster on the map.

As Richardson dug into the books at Napster, she found herself in unfamiliar territory. For starters, Amram’s initial $250,000 investment was under John Fanning’s control far longer than Richardson had expected. Fanning and a marketing deputy were each drawing monthly salaries of about $5,000, despite having no executive positions. After Amram insisted, Richardson got control of the money and cut off the payments. Richardson also found that Amram had paid 20 cents a share for some of his Napster stock and just 2 cents for other shares, direct from John Fanning. That bargain was “the chess move John made to get Yosi on his side” during board
disagreements, she concluded. And Fanning kept enough shares to veto the issuance of a new class of stock, the conventional way to bring in a venture capital firm. While it’s unclear exactly how much John Fanning made through the course of Napster’s life, he took in more than $300,000 by selling some of his shares to new investors and executives at the time of the move to California. Richardson and Sean Parker believe he eventually cleared roughly $1 million, a figure that other Napster investors agree is in the ballpark and that dwarfs Shawn Fanning’s final take of perhaps $200,000.

At board meetings, Richardson and John Fanning exchanged shouts and curses. Few arguments were as important as the fight over which venture offer to take. Both Richardson and Amram wanted Kleiner Perkins Caufield & Byers, which had backed Sun Microsystems, Netscape, and Amazon.com. Kleiner was convinced that Napster would lose in court, but the firm proposed that Napster merge with a smaller, legitimate company, with Kleiner investing in the combined entity, valuing Napster’s piece at $100 million. A new Kleiner-backed CEO was likely to support serious talks with the record labels before Napster lost a judgment and it was too late.

In a tense two-hour conference call, Richardson and Amram urged John Fanning to support the Kleiner deal. “This could jump-start Napster,” Amram told him. “This can change the game.” Fanning capitulated. After they hung up, Richardson held her breath. Just as she feared, only an hour had passed before Fanning changed his mind, telling her that the other firm was getting too much of Kleiner’s money. The deal died, and soon the only venture firm still interested was Hummer Winblad. After Hummer invested, Hank Barry took over, and Richardson resigned.

Unlike many of his counterparts, Barry thought Napster would win in court. But a federal judge granted a preliminary injunction in July 2000 that would have crippled the service, and Napster stayed alive only because two higher judges granted an emergency stay pending an appeal. During the wait, Napster users soared into the tens of millions – the sort of audience that made some media executives rethink everything.

On Halloween day 2000, German publishing
conglomerate Bertelsmann AG, owner of number-three record label BMG, stunned the music industry by announcing it would invest in Napster. Bertelsmann’s loans, eventually totaling $85 million, were convertible into majority ownership and were secured by Napster’s technology assets. That way, Bertelsmann CEO Thomas Middelhoff figured, he could end up with Napster if the firm reached a settlement or even if it wound up in bankruptcy.

The record labels pressed on with their suit, forcing Napster’s shutdown in July 2001 as Shawn and his colleagues tried to develop a copyright-friendly version of the service. Near the end of 2001, with Napster dormant and broke, Bertelsmann began to feel that it would have no liability if it took the company over. For a modest amount of money, it could buy the remainder of Napster and reap all the benefits if it settled with the other labels. Bertelsmann offered $15 million on top of the previous loans. That amount was probably low enough by itself to enrage John Fanning, never one to underestimate Napster’s worth. But that was just the start of it. Two years before, Hummer Winblad had won what is known as a liquidation preference for its investment. The clause meant that if Bertelsmann was going to pay only $15 million, Hummer would get the lion’s share, and John Fanning, Shawn Fanning, Sean Parker, and Eileen Richardson would get nothing at all for their remaining shares.

John Fanning and his lawyers pored over the documents until they found what he considered a sufficient loophole. As is typical with young companies, several series of stock issued by Napster could be converted into common shares if a majority agreed. But the class of shares owned entirely by Yosi Amram appeared to have a strange twist. Those documents said that if that class of stock wanted, it could convert not just its own shares but everyone’s shares into common stock. Napster’s management, led by Barry, dismissed the wording as a careless error. But it was enough for John Fanning, who got Amram to invoke the conversion clause as Napster’s board prepared to weigh Bertelsmann’s offer. Converting Hummer Winblad’s shares to common stock meant that its liquidation preference would evaporate, so that everything Napster took in from a sale would be divided evenly among the shares.

John Fanning’s second goal was to take back the company. If Hummer Winblad no longer had special
shares entitling it to name two of the company’s four directors, then the other shareholders could vote them out and try their own negotiation with Bertelsmann. So it was that disgraced director John Fanning tried to round up a majority of the newly common shares and knock Barry and John Hummer off the Napster board. John Fanning called his nephew Shawn, Richardson, and Parker. One by one, they came to the same conclusion: John Fanning’s greed might for once work in their interest as well.

In March 2002, John Fanning sued Barry and Hummer, claiming that all of the shares had been converted and that a majority of the now-common shares had voted to elect Fanning allies to the board. The suit didn’t go well for John Fanning, especially after Amram withdrew his support. And Fanning didn’t impress the Delaware Chancery Court judge in the case with his unique performance in a pretrial deposition. Fanning testified that he didn’t recall anything about his coupplotting with Amram.

“Did you discuss with him what the effect of his conversion of his shares would be?” an attorney for the directors asked.

“I don’t know,” John Fanning replied.

“You don’t remember?”

“I don’t have a specific recollection of a discussion that I would characterize in that way,” Fanning said.

“How would you characterize your discussions with Mr. Amram on the subject of converting his Series A preferred stock?”

“I’m sorry, how would I ‘characterize’ them?” Fanning asked.

“Yes,” the lawyer said.

“I wouldn’t characterize them,” Fanning said.

Not wanting to get in the middle, Bertelsmann demanded a unanimous Napster board vote on its offer. At first, Barry refused to cut a deal with John Fanning. “We don’t negotiate with terrorists,” he told others. But a bargain
was reached that would give John Fanning and the other early holders $2.4 million, while the rest of the investors split $14.1 million. All that remained was to seal the deal with Bertelsmann.

Surprisingly, even with the total $16.5 million price established, the talks with Bertelsmann dragged on, in part because of a dispute over whether Bertelsmann would cover Barry and Hummer’s personal legal liability. Soon the deadline on Bertelsmann’s offer expired, and it withdrew the deal.

Bertelsmann then proposed buying just Napster’s assets through a Chapter 11 bankruptcy reorganization. Napster filed for bankruptcy in June 2002, but the court blocked the sale. Shawn Fanning and others resigned, and Napster’s technology and website were put up for auction. John Fanning tried to launch a bid but fell short. Then he tried claiming in a court filing that he still owned the Web address Napster.com. When Fanning didn’t testify in support of his claim, a judge tossed it out and approved a sale of the technology and address to Silicon Valley software firm Roxio Inc.

At least temporarily, John Fanning accomplished a lot of what he had set out to do. He received virtually no negative press, leaving Richardson and Barry as the most common targets for Napster critics. Meanwhile, John Fanning raised millions for a new Internet holding company called NetCapital. A draft of Fanning’s presentation to investors crowed that Napster had done so well because of how Shawn Fanning had been cynically marketed by the real powers at the company. “Creating a mediafriendly Cinderella story around a 19-year-old programmer and propagating a viral marketing strategy targeting early adopters allowed the business to grow very quickly with limited investment,” the draft said.

NetCapital is housed behind grimy glass on an oceanfront street in Hull, sharing a block with restaurants that are closed except for weekends, closed except for summers, or just plain closed. When I knocked last spring and introduced myself to John Fanning, he shook his head, gave a half-smile, and shut the door without a word.

In August 2002, John Fanning fulfilled another dream. In recognition of his largely theoretical plan to distribute film content online, the now-defunct business magazine Red Herring put him on its cover under the headline “The Next Movie Mogul?” The article said

Fanning had “created” and “masterminded” Napster, leaving Shawn Fanning seething.

But even then, Shawn tried to tune out the drama. It was the one habit that most frustrated his longtime friends, all the way back to his acceptance of the 70/30 split with his uncle. “John Fanning believes in the ascendancy of will,” Parker says. “Shawn is the polar opposite. He thinks there’s an angel on his shoulder, that everything will work out for the best.”

Joseph Menn is a reporter for the Los Angeles Times. This article is adapted from the book All the Rave: The Rise and Fall of Shawn Fanning’s Napster, copyright © 2003 by Joseph Menn. It is used by arrangement with Crown Business, a division of Random House, Inc.