



Prepared by Will Page,
Executive Director, Research,
MCPS-PRS Alliance

Is Mechanical Copyright Going LaLa?

A new online music sharing service looks set to deliver a further blow to mechanical copyright, and this time - it's physical.

One of the biggest ironies of copyright law is that of the first sale doctrine - where a second hand record store can freely trade copyright content without paying a royalty. So what happens when this secondary market for physical goods goes online? The Alliance's Executive Director of Research Will Page investigates a new business model with 200,000 members who are willing to find out.

'Like any used CD store, "LaLa.com" is 100% legal' claims the website's FAQ section. With a reported \$9 million in venture capital funding now being pumped into the project, it's worth working through what LaLa is, and more importantly what it isn't.

Let's begin with an all-too-common behavioural observation of today's music consumer.

Increasingly, the first thing they do with a newly purchased CD is to burn it onto their laptop. Job done, what durable value does the physical plastic disc then have? The answer must hover above the word negligible. But, consider what happens when a new business model aims to facilitate and monetise that piece of plastic via legitimate CD sharing. That, in a nutshell, is what LaLa.com is about.

LaLa works like an eBay auction exchange, by encouraging consumers who sign up for the service to list all the CDs they may want to exchange as well as ones they would be interested in receiving. Once an exchange is arranged, the recipient pays \$1.49, of which 49 cents pays for shipping the disc,

leaving \$1. LaLa states that 20 cents of each \$1 will go into a charitable fund called the Z Foundation for musicians. It plans on keeping 20 to 30 cents for itself, with the remainder covering administration.

So, here's a model that aims to give musicians a cut of the proceeds while largely freezing out record labels and other traditional intermediaries; meaning that LaLa will also circumvent traditional copyright and royalty payment systems to compensate identifiable working musicians.

Now, before the legal counter argument weighs in, note this is a second hand market where those musicians wouldn't have been compensated anyway. This confuses the standard arguments for and against the sharing of music.

It could be argued that LaLa has exploited that disconnect between mechanical (primary) production value and secondary consumption utility, but equally, one could argue that they've repaired it.

In addition, it's the fans and artists who will jointly decide whether a musician who applies for compensation will get paid under the system. This might sound slightly unusual to the outside world, but the concept may not be particularly alien to collecting societies where governance by membership is the norm.

So let's look at the economics by starting with the consumers - what's in it for them? Well, for it to work, the benefits (a new CD) must outweigh the costs (\$1.49) of sending a CD. Set this against the perceived legal cost of file sharing against the benefit of a lesser quality mp3 file for free. Now, consider the fact that the artist is receiving 20%





when, under copyright law, that second hand resale would have given them nothing. For the consumer, the Unique Selling Point (USP) is a second hand CD for a socially justifiable \$1.49.

Now, consider the economics facing LaLa itself - how do you successfully launch a business with above-zero transaction costs, when similar start ups like Switchdisks.com and Titletrader.com are offering the same service for free. For LaLa, their USP are three-fold: (i) there will always be a cost of distribution, but LaLa competes on convenience by covering as much of the upfront costs as possible, (ii) network effects imply the more users the bigger the benefits, and LaLa already has a library of 1.8 million - that's twice the size of Amazon, and (iii) lock in effects as LaLa is intent on building up a community where good traders are rewarded and bad traders excluded.

Now consider the economics facing mechanical copyright. What did it used to mean, in terms of lost revenues, when a hit band released a long awaited album which duly flopped and was to be found in the second hand bargain bins only a few weeks later. Mechanical copyright is paid on the original press up or sale - so the label reigns in on production, consumers maximise consumption and the effective royalty base is eroded. It could be argued that LaLa has exploited that disconnect between mechanical (primary) production value and secondary consumption utility, but equally, one could argue that they've repaired it. The net effect, in terms of sales, remains to be seen.

So, what is it? The RIAA has taken a hands-off approach thus far which suggests that it is legal. Membership has doubled to 200,000 since the trial beta version, which suggests that it is popular. Donations into and out of the Z foundation have already taken place, which suggests that it is compensating creators. The question then turns to what it isn't. Well, it isn't in the UK, and it isn't the Harry Fox agency, yet. But - as a projected 50% of its revenue is expected to come from its fast-developing first-hand music sales alone - it isn't going away either.
