Buying and Selling Music Catalogues

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A catalogue of old "standards" from the 1950's and 60's is up for sale.

A songwriter with an extensive "back catalogue" of hits wants to cash out.

A major music publisher wants to expand via acquisitions.

A motion picture studio needs to sell its music library to finance films.

A private equity fund sees an opportunity in music publishing.

TYPES OF ACQUISITION AGREEMENTS

Acquisitions in the music publishing area come in many shapes and sizes, and cover a large number of variations depending on what the seller wants or needs to sell, as well as what the potential buyer wants or is willing to acquire.

There are seven main types of acquisition transactions which can be categorized as follows:

1. Sale of publishing and copyright interests in an existing catalogue;
2. Sale of publishing and copyright interests in an existing catalogue without administration;
3. Sale of publishing and copyright interests in an existing catalogue where the seller also has active writer agreements with future commitments;
4. Sale of non-performance songwriter royalties (e.g., royalties from mechanical, synch, print, etc.);
5. Sale of songwriter performance royalties (e.g., ASCAP, BMI, SESCAC, GMR, or other performance society royalties);
6. Sale of United States termination publishing rights; and
7. Sale of the actual legal entity or entities that own the music assets (as opposed to the buyer acquiring only the assets themselves).

There are pluses and minuses in each of the above acquisition types, many of which will affect the purchase price of the transaction. For example, if you are buying publishing rights from a writer who has a co-publishing agreement with another publisher which controls the administration of the compositions, that is, to many buyers, less attractive since you are acquiring a passive interest because you do not have the ability to license or the right to collect income directly from users or from collective rights management organizations. This same rationale is true if a publisher is buying songwriter royalties from a writer who is signed to another publisher who has administration rights to the compositions (although this will not affect the rights of the buyer to collect the songwriter's share of performance royalties from the performing rights organization if that is what is being sold). These are just two examples of many that may become considerations in the determination of a final purchase price and whether the potential buyer wants to go forward with the acquisition. It should be noted that there are some companies that prefer the acquisition to be one of a passive investment without the expense of administration but this is usually not the case.

Before getting into some of the ins and outs of buying and selling musical assets, it should be mentioned that acquisitions can come in many sizes. It might be for one composition, many compositions written by one writer, compositions written by many writers, a set catalogue where there is a defined group of existing compositions, the assets of a publishing company that has active writers signed to it where there are future rights and financial commitments, non-performance songwriter royalties only, songwriter performance royalties only, non-performance and performance writer royalties combined, passive investment vs. active investment with administration and control of the assets, etc. It should be mentioned that this article is focused on asset sales and not on sales of the legal entities owning the assets since, in the majority of cases, acquisitions involve the musical works that are owned by the legal entity and not the legal entity itself.

HOW IT STARTS AND WHAT ARE THE STEPS

It could be a meeting. It could be a phone call. It could be an email or a text. Regardless of how or why it happens, thousands of dollars, hundreds of thousands of dollars, millions of dollars, hundreds of millions of dollars, or over a billion dollars might be at stake for both the seller and the buyer of music publishing rights and related assets.

NON-DISCLOSURE AGREEMENTS

These agreements (referred to as "NDAs") are many times the starting point of any major acquisition transaction. They are basically agreements that stipulate that the potential buyer will not disclose any substantive financial, business, or legal information about the assets for sale which are provided by the seller for review. There are limitations in these documents, such as non-application to information that is independently created by the buyer or the use of information that has been made public. There is, many times, a time limit to the confidentiality provisions, but this is purely negotiable.

It should be noted that, on occasion, due to the relationship of the parties or because the transaction does not involve large amounts of money, an NDA is not a part of the process. In the case of a potential buyer already co-owning or administering the rights being offered (such as acquiring the co-publisher's share of copyrights that it

administers or the songwriter's share of income derived from compositions it controls), an NDA is not necessary since the potential buyer is in possession of all the information that it needs to value the transaction.

THE PROSPECTUS

The prospectus is the document that is prepared by the seller to give the potential buyer information about the assets being sold. Depending on the size of the catalogue being offered and the amount of information being provided, it can range from 5 to 10 pages to over 100. Included in the document, among other things, is information concerning the titles of the most important musical compositions, the names of songwriters represented, trade paper chart and synchronization activity, foreign subpublishing and administration agreements, active writers if there are ongoing agreements, joint venture arrangements, upcoming use commitments such as single or album releases, and, most importantly, the initial financial information as to the earnings of the catalogue usually on a year to year basis for at least 3 years.

THE PROCESS LETTER

In addition to the NDA, some sellers—although this is not that common other than in major acquisitions where there are multiple potential buyers—send what is known as a process letter, which dictates (or attempts to dictate) how the sale will proceed and will include many of the terms that the buyer wants the potential buyers to agree to before any intensive due diligence takes place. Included in this process letter may be:

a. An initial non-binding purchase price that the buyer is prepared to pay and, if there is a range, the lowest value in the range;
b. A description of how the buyer reached its valuation;
c. Details as to how the acquisition is going to be financed;
d. The scope of information that will be required by the buyer before it can make a final binding offer to acquire the assets;
e. A list of approvals and any other conditions which are required in order to enter into a final binding acquisition agreement;
f. Details concerning the identity, capital structure and ownership structure of the final buyer; and
g. A list of the names, positions and contact details of the potential buyer's key contacts and due diligence personnel (both legal and financial) who will be investigating and evaluating the assets controlled by the acquisition.

In the event that this process letter approach is utilized and agreed to by the potential buyer, there usually is a second process letter issued to those potential buyers who have been accepted by the seller as approved buyers, after the due diligence has taken place which will set a specified date as to when a final binding offer must be submitted.

THE LETTER OF INTENT

The buyer's initial acquisition proposal is referred to as a letter of intent (or "LOI") or memorandum of understanding (or "MOU"). This document represents a brief overall proposal after the buyer has reviewed the preliminary information provided by the seller and is always subject to the comprehensive legal and financial due diligence investigations that take place once the parties agree to go forward. On occasion, these initial documents are signed by the seller and buyer to ensure that there is a commitment to go forward on an exclusive basis for a stated period of time to finalize the transaction at a stated purchase price subject, of course, to all of the legal and financial assumptions on which the agreed upon price being met.

These letters of interest are usually kept very short (e.g., 4 to 6 pages without exhibits) and contain only substantive terms such as:

a. The purchase price including how and when it will be paid as well as any earn out bonus provisions or holdback contingencies;
b. Primary assumptions on which the offer is based (e.g., administration rights, term of the rights, effective date of royalty acquisition, no pending or threatened litigation, no unrecouped advances, full right and authority to enter into the agreement, etc.).

There is usually a proposed timetable for completion of the legal and financial due diligence (e.g., 4 weeks, 2 months, etc.) and an exclusivity provision whereby the seller agrees that it will not engage in negotiations with any other third party during the agreed upon exclusivity period.

And whether or not these LOIs or MOUs are eventually signed (they can be extensively negotiated), they do establish a firm groundwork establishing a real basis for going forward by the parties.

DUE DILIGENCE

Due Diligence is the term that describes the procedures and processes that the potential buyer utilizes in its investigation of the assets being acquired. Due diligence is usually split into two distinct separate, but inter-related aspects. One is financial due diligence and the other is legal due diligence. A brief explanation as well as some of the primary focuses of each follow:

Financial Due Diligence

One of the roles of those who are conducting the financial due diligence investigations of the assets being sold is to try to arrive at a sense of what are the sustainable earnings of a catalogue; that is, earnings that will likely continue at their current historical pace or even if diminishing, will not do so in dramatic fashion. Since many acquisitions base the purchase price on the average annual net retained earnings over a period of time, the financial due diligence team will look for any aberrations or one time cash infusion events which have influenced the earnings, but which will not (or likely will not) happen again in the future.

a) Analyzing Earnings
An essential part of the due diligence aspects of an acquisition is an analysis of past income as well as a projection of future income

b) Past Earnings
In reviewing the past earnings of the catalogue that you are buying, you have to separate the major sources of income (performance, synchronization, mechanical, print, other), both with respect to the United States (if a U.S. company) and all territories outside the United States. In addition, you have to have the knowledge as to what sources of income are decreasing in importance, increasing in importance, and staying steady since this factors into the buyer's view of what is sustainable and what is not. Such knowledge of industry trends is essential once the buyer begins its future income projections, since there is always a discussion as to what prior income should be discounted or reduced in any valuation. In recent years, performance and synchronization have been by far a publisher's primary sources of income with mechanicals coming in third.

c) Chart Activity Earnings
Compositions which attain high positions on the trade paper radio and streaming charts earn substantial royalties from the performing rights organizations in the United States, ASCAP, BMI, Global Music Rights, and SESAC. Once the chart activity period is over, however, the earnings for most compositions will drop. Recognizing this, those involved in the financial due diligence aspects of the transaction will reduce the past performance income from chart activity periods to a more sustainable level when including that type of income in their calculation of sustainable annual earnings.

d) Non-Re-Occurring One Time Income Events
Since one of the primary objectives of financial due diligence is to determine what past income is sustainable and received in the normal course of business, one time cash infusion events which may not re-occur in the future or that should have been paid in accounting periods prior to the periods that are being reviewed will be identified and either discounted in their entirety or reduced when making a determination as to what should be included in the seller's average annual income computation.

For example, there may have been a recovery from a judgment or settlement of a copyright infringement claim. There may be monies recovered from an audit of a record company with respect to past sales which should have been reported and received during a period prior to the base period being investigated. There might be receipt of monies from an industry settlement related to past conduct or a separate retroactive special distribution from the performing rights organizations which covered periods prior to those being considered in computing the test period monetary receipts. The above are just a few possible non-recurring situations or out of period earnings which may justify a total or partial deletion from the earnings of the period being investigated.

e) Performing Rights Organization Bonus Provisions
ASCAP and BMI both add bonus payments to compositions which have substantial activity. The primary examples of compositions that fit into this category are those with significant radio and streaming chart activity as singles (all genres), compositions with a past history of cumulative performances ("standards"), songs, themes, and scores in Nielsen highly rated television shows, among others. SESAC also has bonus provisions for certain categories of compositions. These bonus payments can, in many cases, double or triple the regular earnings for a composition. Since the buyer is trying to determine what the sustainable income from a composition is in future years, those in charge of the financial due diligence of the catalogue will usually discount or totally delete such chart activity bonus monies from its calculation of what should be included when determining the average annual income since these types of bonuses will not re-occur unless the composition once again has activity that qualifies for a bonus. The bonuses which apply to compositions which have a long history of substantive earnings and performances (e.g., "standards") will usually not be discounted since they are likely to continue in the future based on their past performance activity.

f) Review of Royalty Payments
There will, in concert with the legal due diligence personnel, be a review of the royalty provisions of the various songwriter and other agreements to make sure that all royalty participants were paid correctly as provided for in the terms of their contracts with the seller. This is not only done to uncover possible royalty audit claims, but also to make sure that the seller has not overstated its retained profit or net publisher's share of income. For example, if it is found that a writer who was supposed to be paid 75% of income received by the seller only received 70%, then the seller's retained profit would be based on 30% of income received rather than 25%, resulting in an overstatement of the seller's net publisher's share of income which would have to be adjusted downward to reflect the true figure.

g) Advances
Another area of inquiry will be whether the seller has received any recoupable advances during the period being reviewed which still remain unrecouped. The unrecouped portion of any advance cannot be treated as actual earnings and needs to be deducted not only from the calculation of net income, but from the purchase price as well since the payer of the advance will continue to recoup the advance from earnings due to the buyer after the closing date of the acquisition agreement.

Legal Due Diligence
As opposed to the financial due diligence team, the role of those conducting legal due diligence is to primarily focus on chain of title issues, copyright status especially with respect to older catalogues, terms of the underlying agreements with songwriters and other parties from which the seller received its rights, potential termination and/or reversion issues, key man or other restrictions on assignment of the assets,

current or potential claims, and future contractual commitments if there are ongoing active agreements, among other areas.

a) Analysis of Future Contractual Obligations

In the event that the acquisition is of a publishing company that has a number of active songwriters under contract, the legal due diligence team will summarize the terms of each agreement including what contract period each writer is in, how many option periods are left, what are the commitments that must be fulfilled to move to an option exercise and, most important, what advances are due each writer for the current contract period as well as any option periods.

b) Foreign Subpublishing and Administration Commitments

Since the seller, in many cases, has made contractual commitments with foreign subpublishers to represent the catalogue outside the United States, the buyer must take subject to those commitments. Legal due diligence will review all such agreements to determine when termination notices need to be sent to ensure that the buyer can select is own foreign representatives; many times, granting such rights to its affiliated companies if the buyer is a worldwide company. It should be noted that many older subpublishing agreements are for the life of the copyright and, in such cases, the buyer must take subject to those long-term commitments. As part of this investigation, the legal due diligence team will review the seller's songwriter and other royalty obligation agreements with respect to any restrictions on the type of fees that can be charged by subpublishers for their services, so that any new contractual commitments will conform with the terms of such agreements. This same exercise will occur if the seller has entered into administration agreements as well.

c) Termination and Reversion of Rights Issues

There will be an investigation of the status of any actual or potential United States termination rights issues (both 35 and 56 year terminations), so that the buyer will be aware of the dates when rights might be lost. The team will first review all notices which have been sent to determine their validity, but also chart the dates of potential future terminations. This is also important since the buyer may want to commence negotiations to acquire those rights where notices have actually been sent especially where the termination dates are somewhat imminent.

In addition to copyright law termination rights, there will be an investigation and report detailing all possible contractual termination rights which are included in the various songwriter and other agreements which allow the writer or other contracting party to terminate the seller's right in and to the compositions. Whether it is full reversion or partial reversion (e.g., the songwriter and co-publisher share only), all will be charted and analyzed.

d) Copyright Issues

A report will be prepared on the top earning compositions detailing any chain of title problems, as well as whether there are any public domain issues, not only in the United States, but foreign territories as well. This is an exercise which is usually only needed when older copyrights are involved or where the songwriter is deceased.

PROJECTION OF FUTURE INCOME

As part of any acquisition transaction, the buyer will make an independent analysis whose purpose is to project future income which will be derived from the compositions since there has to be a sound financial basis for doing the acquisition, since the buyer is usually paying substantial sums of money upon the signing of the agreement with future installments in some and it will not see a complete financial return on the investment until years into the future.

It should be mentioned that the seller, in its prospectus of the catalogue, will provide positive information about the quality of the songwriters, chart activity, the potential of future hits, upcoming releases, pending possible or real commitments from television, motion picture, and video game producers as well as, in many cases, its own projections of future income. All of these must be checked independently since the prospectus, although offering valuable information, is also (and, many times, primarily) a sales tool to get the catalogue sold.

THE PURCHASE PRICE

A number of things go into the equation which results in the actual purchase price, as it is just not as simple as saying if a catalogue has averaged "$_____" in net publisher income ("NPS") over the past 2 to 5 years, we will pay a multiple of 8, 10, 12, 15, etc. of that amount. "Net Publisher Share" is defined as gross royalty income received by the selling company, less all royalties payable to songwriters and other third parties.

PURCHASE PRICE MULTIPLES

The whole concept of multiples is many times a misnomer and often a simplistic view of looking at an acquisition since there are many factors that go into a buyer's decision to offer a certain price to buy a catalogue or come to a monetary valuation.

In most cases, a multiple is backed into only after there has been a determination of what the average annual net income is for a catalogue and a purchase price agreed to. For example, if a catalogue had an average annual NPS of $1,000,000 and the purchase price paid was $12,000,000, the seller will say that the catalogue was sold for a 12 multiple (i.e., $12,000,000 / $1,000,000 = 12). This type of analysis may be easy to understand and very tidy, but it is many times far from the realities that go behind how the buyer values the catalogue and arrives at a purchase price including the fact that certain compositions are valued more for their income and licensing sustainability than other compositions resulting in what is known as a "blended multiple". But again, it must be stressed that arriving at a final purchase price is not a simple number x NPS calculation.

U.S. TERMINATION RIGHTS

When acquiring U.S. termination rights, the focus is somewhat different than in a normal sale agreement, due to the

fact that the rights being bought are for the territory of the United States only and not for the world. Whether the effective termination is either 56 years from the date of the original copyright registration as provided for in Section 302 of the U.S. Copyright Act or 35 years from the date of the grant provided for in Section 203 of the same Act, the initial inquiry has to be a determination of whether the notice has fulfilled all the necessary requirements for an effective termination. It should be noted that the notice can be sent to the original and/or current music publisher (as successor-in-interest to the original publisher) as early as ten (10) years prior to the effective termination date. Under the law, only the current publisher is allowed to acquire the termination rights prior to the effective termination date. In the event that no agreement has been reached prior to such date, then the U.S. termination rights may be either retained by the writer (or heirs and/or estate, if deceased) or sold to a third party.

The prospective buyer's financial due diligence team will concentrate on U.S. income only to determine the value of the rights since territories outside the United States remain with the current publisher and its foreign subpublishers under the law.

BUYING AND SELLING SONGWRITER ROYALTIES

At one time, it was very uncommon for a songwriter, composer, or lyricist to sell their authorship royalties (referred to herein as "Songwriter Royalties"). These are the royalties that are received as a creator as opposed to those received as a music publisher. For example, if a musical work is commercially exploited and earns royalties (such as a synchronization fee for use of a composition in a motion picture or television series, or a mechanical royalty for a download of the composition via iTunes, etc.), the music publisher and the songwriter will each be entitled to 50% of the monies that are paid by the user.

In today's music industry, however, such sales have become more common both with respect to non-performance royalties (e.g., the writer's share of royalties due for synchronization, mechanical, and print licenses which are collected by the music publisher to whom the writer is signed), but also the writer's share of performance income distributed by the writer's performing rights organization such as ASCAP, BMI, SESAC and GMR).

With respect to the sale of songwriter non-performance income, an assignment of such rights from the writer and a letter of direction to the music publisher which controls the musical compositions to which the writer is selling his or her royalties will usually be sufficient to effectuate the transaction in addition to, of course, an asset purchase agreement.

When dealing with a sale of the writer's share of performance royalties, however, it must be mentioned that both ASCAP and BMI have specific forms that must be completed and regulations followed for the assignment to become effective. For example, in order for ASCAP to accept an irrevocable assignment of songwriter performance royalties, the assignor must have earned a minimum of $25,000.00 in writer royalties over the past four distribution periods, or one year, or at least $125,000.00 in writer royalties from a performing rights organization over the last twenty distribution periods, or five years. If the writer does not meet the above minimum earnings threshold, the authorization will be revocable. It should be noted that there may be non-returnable processing fees that must be paid to the applicable performing rights organization for such a sale to be finalized. At ASCAP, the current fee is $250.00. At BMI, a $500.00 processing fee will be deducted from the first royalties payable under the assignment; $250.00 if the entity to which the royalties are being assigned to is a corporation, LLC or trust solely owned by the writer.

The assignment should also be very clear as to the exact royalty stream that is being sold. For example, BMI's form has three categories:

a. "My royalties earned from all works in my BMI catalogue on the date of this assignment or that may be entered into in my BMI catalogue afterwards;
b. My royalties earned only from the works that are in my BMI catalogue on the date of this assignment but not my royalties earned by works that may be entered into my catalogue afterwards; and
c. My royalties earned only by the works on the attached schedule."

Additionally, the assignment should be very specific as to the date that the transfer of ownership to the royalty stream will take effect, as such date should commence, if at all possible, at the start of a calendar quarter to accommodate the applicable performing rights organization regular royalty distribution dates (e.g., January 1, April 1, July 1, or October 1).

It is important to note that, for many years, the sale or assignment of writer royalties was very limited by the rules and policies of the U.S. performing rights organizations. In recent years though, many restrictions have been removed, making it easier for writers to accomplish these types of transactions. Nevertheless, it is essential for anyone involved in these types of transfers to be aware of the current policies and required documents needed to effectuate these types of sales and assignments.

CONCLUSION

Music use is at an all-time high both in the traditional media area as well as in the online/digital world. The proliferation of new types of platforms have created many new possibilities and opportunities for the exploitation of musical copyrights-and with those opportunities come increased value. Whether a buyer's interest stems from an investment opportunity, a desire to increase market share, or a realization that its ability to compete in a world of multinational communication conglomerates necessitates the acquisition of copyrights or additional copyrights, and whether the seller is motivated by a desire to monetarily capitalize on a valuable asset, or a need for a substantial cash infusion into a business or for estate planning purposes, the music publishing business represents an investment that rarely disappoints either the buyer or the seller. ■

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Note: Additional information as to the subject matter of this article can be found in the "Buying and Selling of Songs" chapter in "Music, Money And Success: The Insider's Guide To Making Money in the Music Business", 8th edition.

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