
Why lending to a music publisher is sound business

Introduction

The music industry is making money again. After a turbulent period which began with illegal file sharing sites such as Napster entering the market and the rapid decline in sales of CDs and vinyl, the sector is becoming profitable again. This is to a large extent due to the revenue generated from the likes of Spotify and Apple Music (although there remain challenges to ensure that artists are properly rewarded for the music they create) and the ever increasing consumption of live music. Of course, underpinning all this is the quality of music being written and the live performances. Thanks to the likes of Ed Sheeran, Dua Lipa and Stormzy, U2, the Killers and the Foo Fighters, the quality of recorded and live music available for consumption, arguably, has never been higher.

Music publishers

At the heart of the current revolution are music publishers who are embracing and driving change. This article looks at the risks and rewards of lending to music publishers in this rapidly changing market.

Music publishing administrators operate on a fairly simple model. They acquire rights in compositions (copyright in musical works and in lyrics) from the owners of those rights (either directly from the songwriters or indirectly from other music publishers who have been appointed by the songwriters) and, in return for a commission payment, collect revenues in respect of the global exploitation of those rights. That exploitation typically involves public performance and broadcasting of music, where the exploiting entity typically pays a local collecting society in respect of the use of a broad music repertoire. Increasingly, exploitation is via international and even global digital services (such as Spotify and iTunes) who may pay a publisher directly or via an intermediary. Publishers can also earn enhanced commission for dedicated music licensing, for example permitting a song to appear in an advertisement or feature film (known as “synch rights” in industry jargon). Publishers may also look to acquire ownership of the rights in the compositions themselves as opposed to merely acquiring the right to exploit them in return for a commission.



However, publishers are also entering into what are for them non-traditional areas of the music business. For example, certain publishers also apply a model similar to that they operate for rights in compositions to “neighbouring rights”.

These are generally the rights of a performer and of a record company to receive a royalty stream from the exploitation, via radio and other media, of their performances as embodied in sound recordings.

Publishers also operate business models for sound recordings which are more like those of a traditional record company, where they are granted rights by artists (bands and solo performers) and arrange for those recordings to be made available through digital outlets (such as iTunes and Spotify) as well as to film and TV producers for use in soundtracks.

Often the publishers will provide a range of marketing support for these recordings and, in a small number of instances, we understand that they arrange for the distribution of physical (CD and vinyl) products.

Risks to a music publisher's business

There are of course industry risks outside of the control of the publisher which could impact on the royalty streams received by the publisher and therefore fundamentally affect its business. These may include piracy; changes to pricing models and distribution policies, especially of the digital service providers; commercial viability of the song; challenges to copyright ownership; and new technology innovation. They also include the fundamental, but highly remote, risk that people stop listening to music.

Away from those industry risks, the main risks lie with the third parties failing to perform their obligations under the relevant agreements and failing to make payments when required to do so (although this could be mitigated to one or perhaps two quarters of lost revenue depending on the terms of the relevant contracts and the frequency of payments made) and, perhaps more fundamentally, the termination of any administration agreements by the owners of the rights where a default situation arises. Again this would depend on the terms of the relevant administration agreements but the practical reality is that these termination rights are only likely to be exercised in the event of non-payment and therefore there should be the ability, whether through step-in rights or otherwise, to ensure that termination rights do not arise.

Nature of a music publisher's assets

As a result of the fairly simple business model music publishers operate, the nature of the assets they own is easy to understand. In essence, their assets comprise of:

1. the ability to exploit rights in compositions and neighbouring rights;
2. rights in compositions and neighbouring rights actually owned by the music publisher; and
3. royalty streams from the exploitation of those rights.

The advantage to a lender of this is that the ability to identify the key assets of the borrower enables the lender to undertake proper due diligence to establish how valuable those rights and assets are and how robust any security package may be. This due diligence would take the following forms.

In relation to the royalty streams, this would be an understanding of the contracts entered into with relevant third parties, including the collection societies and entities such as Spotify and Apple. This would be coupled with a review of historic, current and anticipated revenue streams as a result of the exploitation of the rights currently held.

In relation to the ability to exploit rights owned by third parties, it would be necessary to review the relevant administration agreements to consider issues such as the ability of the rights owner to terminate the administration agreements (for non-payment, insolvency or otherwise), whether any advances were paid to the rights owner and to what extent those advances have yet to be fully recouped (this will clearly also impact on when any right to terminate for non-payment may arise) and the duration of any agreement.

In relation to rights owned by the publisher, diligence would extend to ensuring title has been acquired by the publisher and identifying any ongoing obligations (payments or otherwise) there may be under the agreement by which the rights were acquired and the consequences for breaching those obligations.

Security package and enforcement strategy for a lender

Any security package should be comprehensive. The lender should seek a comprehensive fixed and floating charge debenture over the assets of the publisher (and all other relevant entities) together with share charges over the shares in each company. This would give the lender all the usual rights of control, the ability to enforce and the ability to maximise recoveries that any lender would usually require. However, what are the specific issues a lender should be concerned with when lending to a music publisher?

Royalty streams – ideally all royalties should be paid into blocked accounts with the lender, which would therefore enable the lender to seize any funds in those accounts in the event of a default.

However, publishers are often resistant to granting fixed charge security over royalties received and the accounts into which they are paid, the argument being that the publisher needs the funds freely available to meet payments due to rights owners and other day-to-day costs. This could potentially be overcome by the lender agreeing, for example on a weekly basis, to allow sums to be released from the blocked accounts to meet these liabilities. The lender would not even have to do diligence as to whether the amount requested was reasonable (although of course they could do) to give the borrower comfort that there would not be delay in funds being released. Any balance left in the account would still be subject to the fixed charge security. However, if the publisher refuses to accept anything other than floating charge security, this would still be of value to a lender. The security would require notice to be served on the account holding bank requiring amongst other things, sums to be paid to the lender following the giving of notice by the lender after an event of default. Preferably the accounts would be with the lender such that in the event of default the lender should be able to take control of the funds in the account, albeit they won't be able to control what funds are in those accounts at that time. If the publisher were to go into administration prior to the lender having taken control of the funds in the accounts then any realisation would be subject to leakage (namely the prescribed part, preferential creditors and costs). If the accounts are not held with the lender then whilst notice can still be served on the account banks at the outset, with the ability for the lender to require the funds to be paid to it in the event of default, there are the practical challenges of gaining control of such funds in a timely manner in such a situation should a default arise. Again any recoveries would be subject to leakage on administration.

In addition, at the outset the lender should take an assignment of all key contracts and ensure notice is served on the contractual counterparties requiring sums due under those contracts to be paid directly to the lender following the giving of notice after an event of default by the lender on the counterparty requiring them to do so.

Rights owned by the publisher – these are intellectual property rights and it should be possible for the publisher to grant fixed charge security over these rights. It should enable the lender on default to recover the full value of these rights whether by the appointment of an administrator or a fixed charge receiver over just those particular rights, or as a condition to giving consent and appropriate releases as part of any consensual restructuring or refinancing.

Enforcement strategy – based on the above, a lender's enforcement strategy may only need to involve taking control of royalties and the underlying royalty streams and/or realising value in the intellectual property rights owned by the publisher. This may be sufficient for the lender to make a full recovery. However, insofar as that is not the case, the lender may give thought to a more comprehensive enforcement strategy involving a restructuring, refinancing or a sale of the business and assets (or shares) of the publisher.

It may be that any restructuring, refinancing or sale is done consensually in which case the lender will use the leverage its security gives it to ensure that it receives full value for the assets over which it has security. This may be the most beneficial solution for the publisher and maximise value. Alternatively, the lender could support an informal wind-down of the operations of the publisher such that it continues to exist purely to collect royalties and service the debt.

If such a consensual solution is not forthcoming then the lender may have to take action to enforce its security. This could involve the lender appointing a receiver over the shares in the publisher (or any appropriate holding company or other entity) with a view to the receiver looking to sell the shares in the publisher. This would enable the sale of the key companies in the group. Alternatively, this enforcement would enable the lender to take control of voting rights to appoint friendly directors to the board of the key companies with a view to cutting costs and trading the business to the extent necessary to collect royalties and repay debt (as discussed above). The advantage of appointing a receiver over shares as opposed to the appointment of an administrator (see below) is that the key commercial contracts are less likely to be terminable in the event of an appointment of a receiver/change of control than the appointment of an administrator over the assets of the company itself.

However, the effect of the appointment of a receiver on the key commercial contracts should clearly be part of any pre-lending due diligence.



The final enforcement option is to appoint an administrator over the key trading entities. This requires the lender to have the benefit of a qualifying floating charge which is therefore a key part of its security package and for its security to have become enforceable.

The administrator would have the ability to trade the business and collect revenues with a view to selling the business and assets as a going concern. However, a key risk with administration is that it is likely to be a termination event under the administration agreements and therefore if those administration agreements are key to the lender being repaid (either by the administrator continuing to trade the business and collect royalties or because of the value they may raise on a sale) then appointing an administrator where there is a right of termination is clearly a significant risk for the lender. Of course this risk is mitigated if the lender is able to make a recovery from the revenue streams that could still be collected and the sale of the other assets of the publisher, including any intellectual property it owns. The other advantage of administration is that administrators are able to bring certain courses of action to seek to make recoveries for the estate which may otherwise not be available. However this is somewhat of a last resort as making any such recoveries is likely to be expensive and uncertain.

In any such scenario, a key consideration is whether it is necessary to ensure that composers and other third party payees continue to be paid so they do not have the right to terminate the administration agreements (assuming there are no other grounds for termination, albeit that non-payment is the most likely ground on which termination rights would be exercised) and therefore ensure that the royalties continue to be collected. This would obviously involve an assessment as to whether it is necessary to continue collecting the royalties to service the debt or whether the lender could be repaid in full from those revenues that would remain to be collected and other realisations.

Conclusions

We said at the outset that music publishing administrators operate on a fairly simple model and their assets are easy to understand. However, what is imperative in an intellectual property and cash-rich business is that detailed due diligence is undertaken prior to providing any loan to assess the robustness of the revenue streams, the ownership of intellectual property, the ability of key commercial contracts (in particular the administration agreements) to be terminated in the event of certain situations and as a result of that to plan at the outset a comprehensive enforcement strategy which can be implemented following any event of default. By the very nature of intellectual property and cash rich businesses, following on event of a default there may be a very limited window within which to act in order to maximise recoveries and therefore it is imperative that the necessary due diligence together with a comprehensive enforcement strategy is undertaken and understood at the outset. Provided that is done, then lending to music publishers should be sound business.

Get in touch



Julian Turner
Partner, Restructuring & Insolvency
T: +44 20 7067 3552
E: julian.turner@cms-cmno.com





Law . Tax



Law . Tax

Your free online legal information service.

A subscription service for legal articles on a variety of topics delivered by email.

www.cms-lawnow.com

Your expert legal publications online

In-depth international legal research and insights that can be personalised.

eguides.cmslegal.com

CMS Legal Services EEIG (CMS EEIG) is a European Economic Interest Grouping that coordinates an organisation of independent law firms. CMS EEIG provides no client services. Such services are solely provided by CMS EEIG's member firms in their respective jurisdictions. CMS EEIG and each of its member firms are separate and legally distinct entities, and no such entity has any authority to bind any other. CMS EEIG and each member firm are liable only for their own acts or omissions and not those of each other. The brand name "CMS" and the term "firm" are used to refer to some or all of the member firms or their offices.

CMS locations:

Aberdeen, Algiers, Amsterdam, Antwerp, Barcelona, Beijing, Belgrade, Berlin, Bogotá, Bratislava, Bristol, Brussels, Bucharest, Budapest, Casablanca, Cologne, Dubai, Dusseldorf, Edinburgh, Frankfurt, Funchal, Geneva, Glasgow, Hamburg, Hong Kong, Istanbul, Kyiv, Leipzig, Lima, Lisbon, Ljubljana, London, Luxembourg, Lyon, Madrid, Manchester, Mexico City, Milan, Monaco, Moscow, Munich, Muscat, Paris, Podgorica, Poznan, Prague, Reading, Rio de Janeiro, Riyadh, Rome, Santiago de Chile, Sarajevo, Seville, Shanghai, Sheffield, Singapore, Skopje, Sofia, Strasbourg, Stuttgart, Tehran, Tirana, Utrecht, Vienna, Warsaw, Zagreb and Zurich.

The content in this document is for general purposes and guidance only. It does not constitute legal or professional advice and should not be relied on or treated as a substitute for specific advice relevant to particular circumstances. For legal advice, please contact your main contact partner at the relevant CMS member firm.