PPA

Buying and Selling Magazines

The legal framework

NELLEN
solicitors

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INTRODUCTION

On 6 May 2003, as part of Magazines 2003, the PPA organised a seminar for the Independent Publishers Advisory Council (IPAC) entitled Growing Your Business. One of the seminar topics was entitled Buying and Selling Magazines and I spoke on the legal issues involved in the process.

Almost 70 participants attended representing a cross section of independent publishers.

This booklet expands on the talk I gave at the conference on the legal framework and is an updated version of the earlier booklet I prepared for the PPA in 1995. It is written for the publisher who needs a brief practical guide to the main legal issues.

It cannot, due to its brevity, be a comprehensive analysis of all the issues that arise in transactions involving sales of magazines but it highlights many of the significant issues that buyers and sellers should address.

The chapter on Valuing a Title has been contributed by Christopher Innis, Managing Director of Chris Innis Associates, a media and media investment consultancy, to whom I am very grateful. My thanks are also due to Nick Mazur and Helen Wilkinson of the PPA for their suggestions and editorial comments, and to my assistant Andrew Milner-White.

NELLEN Solicitors is a specialist corporate law firm which represents companies and entrepreneurs in a variety of sectors, including magazine publishers.

We advise our clients on a broad range of corporate and commercial legal issues and transactions including magazine sales and purchases.

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. VALUING A TITLE

What is my title worth or what could I sell it for? How much should we pay for a particular title? What adds to or detracts from the value of a title? These are key questions often asked by publishers.

The valuation of any business is an inexact science where value is often determined by the personal circumstances of the buyer. This is particularly true of publishing. The methodologies used to value a publishing business vary but can be reduced to two central ingredients: profit (or, more precisely, cashflow), and revenue (or more precisely, the market position of the title, the quality of it's earnings and the title's share of it).

To value a publishing business, publishers apply a number of methodologies to these two separate ingredients. Methodologies include discounted cashflow analysis, price earnings ratios, or a multiple of revenue. Price earnings ratios and revenue multiple are invariably based on past analogous sales or listed trading multiples.

However, whilst past sales provide a guide, they lack precision as no two businesses or buyers are the same. Any methodology is only as good as its assumptions which are particular to each publisher. For example:

- a different assumption on the cost of capital will give a different result on a discounted cashflow valuation or

- an assumption about the quality of management and assets will affect the price earnings ratio or the revenue multiple used.

- Irrespective of the methodology, there are general issues that are relevant to any valuation of a title. These are:

- the market the title is in

- the frequency of the title

- the market share of the title
- the sources of its current revenue and potential for other sources of revenue
- the quality, sustainability and potential growth of the title's revenue - here competitive pressures are especially relevant
- the cost base and margins of the business and its titles
- the opportunities the potential acquisition gives to enter other markets or revenue by launch or acquisition, and
- rationalisation benefits.

How each of these issues is treated by a publisher often explains the diverse valuation methodologies used in publishing and very often the apparently high price earnings ratios reported in the press.

Few publishers purchase titles unless they can improve their performance, preferably through the creation of new revenue opportunities, but more often through a rationalisation of the cost base. Therefore, where multiples are high, economies of scale will usually reduce the multiples quickly over a two to three year period.

These circumstances, so individual to each publisher, perhaps explain the inexactness of the valuation science.

2. ENGAGING A BROKER?

One of the early decisions a seller must take is whether to negotiate directly with potential buyers or to use an intermediary, such as a broker, to market the title and negotiate the terms of the deal.

If the seller decides to appoint a broker, they will be asked to sign an engagement letter. Although superficially a simple contract, a seller should refer the agreement to their lawyers – they are complex documents which have been a fertile area of litigation.

Any agreement with a broker acting for a seller should deal with the following principal points:-

- Fee: The contract should set out precisely how the fee is to be calculated (usually a percentage of the sale price – the level depending on what the parties have negotiated since there is no industry-standard fee scale), and should clearly state the circumstances in which it becomes payable. The fee should normally only be payable on completion of the transaction, although a retainer and expenses might also be payable whatever the outcome.

- Exclusivity: Is the appointment to be exclusive or non-exclusive? Exclusivity gives the broker the right to a fee if a sale takes place during the exclusivity period. The fee is payable whether or not the broker is the effective cause of the sale and is payable even if the title is sold to a buyer identified by the seller.

- A non-exclusive appointment, however, entitles the broker to a fee only if the broker has been the effective cause of the sale – sometimes a difficult issue to determine.

- Duties: The agreement should detail the broker's duties, for example, to provide the seller with progress reports. The seller may wish to agree with the broker which potential purchasers are to be approached and to ensure that

potential buyers enter into a confidentiality agreement before receiving an information memorandum.

- Term: The seller and the broker should agree a period during which the broker is appointed. However, a seller should be aware that the broker might, unless the agreement is carefully drafted, be entitled to a commission if a sale takes place within a reasonable period after the expiry of the term, if that sale is to a buyer originally introduced by the broker.

- Expenses: In the absence of express wording to the contrary, agents who work on a commission basis are not entitled to any expenses. However, the agreement should nevertheless make this clear, though it is not uncommon for brokers to ask for a retainer or a contribution to expenses.

- Termination: A seller might wish to retain flexibility to withdraw the title from the market and bring the agreement to an end before the expiry of the contract period. A seller though, cannot use early termination of the agreement as a device to circumvent the payment of legitimate commission.

3. CONFIDENTIALITY AGREEMENT

An intending seller usually prepares (in conjunction with their advisors) an information memorandum containing a profile of the business, its management and financial performance (for, say, the last three years).

An information memorandum should be carefully prepared and should be honest, complete and accurate. Inaccuracies will usually be exposed during due diligence and render a seller vulnerable to a renegotiation of the offer price. Sellers may also be required (in the sale agreement) to warrant the accuracy and completeness of the information provided during due diligence (see Chapter 8 - Warranties).

Because of the sensitivity of the information, sellers usually require prospective buyers to enter into a confidentiality agreement in which a buyer:-

- acknowledges the confidentiality of the information received

- agrees to ensure that all persons receiving the information maintain its confidentiality

- undertakes to use the information for assessing the business and for no other purpose, and

- undertakes to return all information on demand or at the conclusion of negotiations.

A short form confidentiality agreement (in letter form) is set out below:

Dear [Buyer]

You have requested that [seller] provides information relating to its business ("Information") so that [buyer] may investigate and evaluate a proposed acquisition of [seller].

In consideration for the supply of the Information by [seller], [buyer] hereby undertakes:

- To treat the Information as confidential;
- Not to disclose the Information to any person other than its employees, directors and professional advisers who are involved in reviewing the Information, and then only on the basis that it is strictly confidential;

  Not to disclose the existence of the negotiations to acquire [seller];
- Not to make copies or reproductions of the Information unless approved by [seller] and
- To return to [seller] forthwith on demand all Information together with all copies made by or on behalf of [buyer], including copies stored electronically.

[Seller] makes no warranty as to the accuracy or completeness of any information provided to [buyer].

Please acknowledge your undertaking by signing and returning the enclosed copy of this letter.

Yours sincerely

[Seller]

4. THE OFFER LETTER

Once a serious buyer has been identified, it would be standard practice for the buyer to submit a formal subject to contract written offer. The offer letter should highlight the key terms of the proposed transaction and specify the assets to be bought (particularly where the sale is of a title rather than the sale of shares in a company owning a title(s)).

Publishers generally prefer, where they have the option, to acquire titles and to specify assets they want to buy rather than buying the company owning the title(s). Company acquisitions bring with them corporate liabilities, (such as potential tax claims), whereas in the case of a business or title sale, the buyer can, by selecting those assets they want to buy, remove the risk of taking over unforseen liabilities.

However, for a number of reasons, the most important of which is usually the tax effect on a company of a sale of an individual title or titles, the seller may not offer a buyer the luxury of choice and insist that the company owning the title(s) must be bought. This will almost invariably be the case where, say, the founders of a publishing company are exiting. On the other hand, where a large company wishes to divest itself of an individual or small group of titles, these sales often take the form of a transfer of the title(s).

These guidelines assume that the sale will be of a title or the business that publishes the title rather than a share (or company) sale, though there are many similarities in the acquisition process including the types of warranties sought.

In the sale of a publication, usually the most important assets will be the intangible assets. These will include the name of the title, the associated goodwill and (registered) trade marks, the copyright in back issues and the benefit of contracts such as subscription contracts and advertising bookings and any contract publishing agreements.

Tangible assets will include the stock of back issues, subscription lists, libraries and records and any relevant share of the sellers' pension scheme (if any). Office and computer equipment, vehicles and leases might also be included depending on the particular transaction. Unrelieved tax losses might be an important asset if capable of being used by the buyer.

Thought needs to be given to the treatment of debtors and creditors. It is normal practice to exclude these from the transaction i.e. the seller continues to receive monies owing to the business (for example from advertisers and distributors) but remaining liable for monies payable by the business (for example, the printing bill) arising before the date of transfer or any agreed cut-off issue.

The unfulfilled subscription reserve (the advance payment from subscribers) is a grey area and an area for negotiation and the offer letter should make it clear who is to get the benefit of this as well as who receives subscription monies due before the transfer but received after that date.

An example of an offer letter for a simple title acquisition is set out below. Every transaction, however, is different and this letter must be adapted to the particular circumstances of every deal.

Dear [Seller]

[Title]

I am pleased, on behalf of [buyer], to offer to purchase the business of [Title] for £[...] which will be paid in full on completion.

Our offer for the business is to include the assets set out below.

1. The title and goodwill, the copyright in back issues and the subscription lists.

2. The stocks of back issues, work in progress and all records.

3. The benefit of existing contracts.

All debtors and liabilities arising before completion are excluded from the acquisition. The unfulfilled subscription reserve as at [completion] is also excluded from the transaction but we will be entitled to subscription monies received after [...].

We would expect to take on [all] the full time and part time staff currently employed by you [but see Chapter 6 – Taking Over Staff] [and the value attributable to them of their interest in the seller's Pension Scheme].

This offer is subject to legal documentation (including standard warranties and restrictive covenants), satisfactory due diligence and access to all relevant records.

Finally, this offer is open for acceptance (subject to the conditions set out above) until [...] and will lapse if we do not receive written acceptance before 6pm on that day. If a valid acceptance is received by us and full access to the records of the business and to key staff is given immediately thereafter, we aim to complete our due diligence by [...] and to finalise and exchange contracts by [...].

I look forward to hearing from you.

Yours sincerely

[Buyer]

5. LOCK OUT AGREEMENTS

One of the ways a buyer might try to reduce the risk of being gazumped is to require the seller to enter into a lock out agreement. Many buyers will not undertake the due diligence process until the seller has entered into such an agreement.

In such an agreement the seller agrees for a fixed period of time not to negotiate with any third party. In other words they lock themselves out of rival negotiations – they do not lock themselves into negotiations with the buyer or bind themselves to negotiate an agreement.

Contrary to the general belief that the breach of a lock out agreement will entitle the injured party to claim the difference between the higher price and the price the buyer would have paid, the only remedy for breaching a lock out agreement is for the buyer to seek an injunction within the exclusivity period and compensation for the costs they have incurred (which of course may serve little purpose and involve significant costs).

A typical agreement is set out below.

Dear [Seller]

In consideration of our incurring the costs of our professional advisers in carrying out due diligence and the preparation and negotiation of the Agreement for Sale and Purchase, you hereby undertake that during the period from today until midnight on [...] you will not negotiate directly or indirectly the sale of [Title] to any person other than ourselves.

Please acknowledge your undertaking by signing and returning the enclosed copy of this letter.

Yours sincerely

[Buyer]

6. TAKING OVER STAFF

Almost all sales of titles will involve the transfer of a business as a going concern to which the Transfer of Undertakings (Protection of Employment) Regulations 1981 apply.

The effect of the Regulations will be to transfer to the buyer the contracts of employment of all employees working in the business at the time of, or immediately before, the transfer. The buyer therefore inherits and is bound by, existing contracts of employment.

The Regulations apply to all employees (whether full or part time) and not, for example, to consultants or freelancers. A buyer should ensure that staff who are described as consultants or freelancers are indeed consultants or freelancers as it is common in the publishing world for people to be described as consultants or freelancers when they are, in fact, employees.

The Regulations cannot be avoided by the seller dismissing before, and in anticipation of, the sale those employees the buyer does not want to take on. In such a case, the buyer will be deemed to have dismissed those employees and will therefore be liable to those employees in a claim for unfair dismissal.

Buyers should also be aware that they will inherit the employees' employment history, for example, arrears of wages, or claims for sexual discrimination or personal injuries and other previous breaches of the employees' employment contracts committed by the seller.

Dismissals connected with a business sale are presumed to be unfair unless the buyer can show that the dismissals were made for "economic, technical or organisational" reasons. Even if this ground can be established by the buyer, it must still show that it acted reasonably and that the dismissals were fair. However, only employees with one year of continuous employment will be eligible for compensation.

If the buyer dismisses some of the staff taken over in the correct (i.e. fair) way, they should be able to avoid any claim for unfair dismissal. But it is likely that the buyer will have to make redundancy payments to staff with at least two years of continuous employment who are dismissed.

As many sales will involve some degree of staff rationalisation, the contingent costs of this exercise might have to be factored in to the purchase price.

7. DUE DILIGENCE

Once an offer is accepted but before contracts are exchanged, the buyer, normally in conjunction with their advisers, will investigate the seller's business. This process is known as due diligence and will often be carried out whilst lawyers prepare the contract.

For the buyer, it is undoubtedly a key stage in the process since it enables them to verify the financial information and other information about the business on which their offer has been based.

An experienced publisher will know the information which will need to be checked – though every title will pose different questions.

Typically a buyer will want to verify the management and audited accounts for the last three years as well as the management accounts and budget for the current year.

The background information supporting the figures such as sales reports from distributors, advertisement bookings and rates, subscription lists and subscription renewals should be reviewed.

On the cost side a buyer will carry out due diligence on the production, distribution and circulation costs and on marketing expenditure – particularly to see if savings can be made in these areas.

Clearly the brand will be vital and if it is a registered trade mark, a buyer will want to see the registration documents and enquire as to any infringements or litigation. The ownership and terms on which copyright in back issues is held is significant (e.g. if compilations or databases or an internet archive are planned) and the contributor contracts should be examined.

Employees' contracts and salaries are highly relevant. Their pension entitlements might be significant if they are members of the seller's pension scheme. If the seller has a scheme then actuarial advice should be sought to review the benefits offered. In due course, the transfer value of the transferring employees' benefits will need to be agreed with the seller's actuary. At the appropriate stage in the process, a buyer will also want access to key personnel, such as the editor, to discuss relevant matters.

The key contracts of the business (such as the printing and suppliers' contracts) will need to be assigned to the buyer, and the buyer should therefore ensure that they are not onerous and are capable of being assigned or renegotiated where the buyer hopes to make cost savings. Commercial contracts are generally assignable unless the contracts provide otherwise or unless they are personal to the parties. The buyer will need to satisfy himself/ herself of this at an early stage.

Leases of property often represent a significant liability. There might be imminent rent reviews or contingent liabilities for repairs. If relocation is proposed, the buyer must assess the marketability of the property.

The existence or likelihood of litigation is another area to be investigated. Even if the action is against the seller, the business might be affected.

Finally, in a company purchase, the taxation affairs will be examined and the buyer will want to make sure that there are no outstanding claims or potential claims by the Inland Revenue which have not been provided for.

8. WARRANTIES

Whilst the due diligence process ought to throw up any inaccuracies in the information supplied to the buyer, the process might not uncover everything, particularly if the deadline is very tight and the buyer has not had the chance of carrying out a full investigation.

The purpose, therefore, of warranties is two-fold. Firstly to encourage disclosure by the seller of exceptions to the general warranties and secondly to impose liability on the seller if they are wrong.

SCOPE

Warranties should be tailored to what is appropriate to the purchase of a magazine title, they should be specific and deal with the essential elements of the business.

Thus a general sweep-up warranty asking the seller to warrant that they have disclosed everything which would influence a buyer's decision to buy the business should be rejected.

Amongst the most important warranties will be warranties covering the accuracy of the information supplied to the buyer. The parties should therefore work towards agreeing a set of warranted documents.

LIMITATIONS OF WARRANTIES

It is standard and accepted that sellers limit the effect of warranties in three ways:

- Amending certain warranties e.g. qualifying a warranty with the words "to the best of the seller's knowledge and belief" or "so far as the seller is aware..."

- By producing a disclosure letter (usually with a bundle of attached documents) which describes specific exceptions to the general statement in the warranty

- Limiting the effect of the warranties e.g. agreeing an upper limit on the amount the seller will pay if a claim is successful (normally this is the sale price) and fixing a date by which a buyer must bring a claim (usually allowing for, say, one or two audits after completion)

DAMAGES

The usual remedy for a buyer who discovers a breach of warranty is to sue for damages. However, claiming for breach of warranty is complex and the calculation of damages is a difficult area of the law. This is why a buyer should rely on due diligence before contract rather than relying on the prospect of recovering money via expensive litigation after completion.

The principle in calculating damages for a breach of warranty is to put the buyer in the position they would have been in if the warranty had been accurate.

In the purchase of a magazine business where the price is usually based on a multiple of prospective earnings and other factors rather than on tangible asset values, the calculation of the buyer's loss is even more difficult. Sometimes attempts are made to pre-estimate the damages in which case an earn-out can be a useful mechanism to offset a liability against sums owing.

9. RESTRICTIVE COVENANTS

It is common for a buyer to seek to protect the goodwill of a title by restricting the seller from re-entering the market to compete with the title which has been sold, either directly or by financing someone else.

Restrictive covenants will be valid if they are considered reasonable – both by the parties at the time and by the courts. If a covenant is contested by the seller, the buyer will have to prove that it is reasonable.

A restrictive covenant should generally be no wider than the activity of the business being sold. In most cases a buyer will be adequately protected if the agreement restricts the seller from re-entering the market sector in which the title operates (e.g. computers or healthcare), rather than a wide restriction on re-entering the periodical market.

In terms of the territoriality of the restriction, the countries where the title is sold (or might be reasonably expected to be sold in the future) would be likely to be considered reasonable.

What constitutes a reasonable duration of the restriction will depend on, for example, the age of the title and its vulnerability to competition. Restrictive covenants of two to three years are common in magazine sales.

10. LEGAL DOCUMENTATION – SMOOTHING THE PROCESS

Almost every sale of a magazine business will be based on a legal contract negotiated between legal teams representing the buyer and seller.

It is standard practice for the buyer's lawyer to prepare the draft sale and purchase agreement so that the buyer is able to insert the protections it requires.

Sometimes, deals can get bogged down in the process of negotiating the detailed legal documentation. Issues might arise in the process which, if not resolved to the satisfaction of the buyer, will impact on the purchase price or lead to a retention. There are, however, a number of ways buyers and sellers can help the process to run more smoothly, and hence reduce the overall legal costs. Here are a few suggestions:-

FOR BUYERS:-

- Ensure the key terms are contained in your offer letter and consider involving your lawyers in the drafting of this since they will be asked to prepare the contract

- Be prepared to be robust and, for example, to take a view on which warranties are essential and which can be deleted or qualified – advise your lawyers accordingly

- Ensure your lawyers keep to the agreed timetable and be available to respond to their questions

FOR SELLERS:-

- When a decision has been made to sell a title or titles, consider the warranties that you might be expected to give and prepare the business and the documentation accordingly. Your lawyers can advise you on the range of

standard warranties

- Gather all the relevant information in files – from recent accounts, to a schedule of employees and their terms and their contracts of employment to copies of any trade mark registrations, leases etc

- Keep a record and copies of all information supplied to the buyer so that this can form the basis of a disclosure bundle

- Try to resolve any material outstanding issues before marketing your title which will have a bearing on the transaction and hence on price eg litigation and tax enquiries (relevant for company sales) or employee disputes etc

- Consider taking legal advice on any offer letter you receive, bearing in mind that even though it is usually not legally binding, it has a moral force and will form the basis of the legal documentation

- Impose a strict timetable and ensure the parties keep to it – the shorter the deadline, the less likely the project will drift and costs will escalate.

OTHER GUIDELINES IN THIS SERIES INCLUDE

- Best practice guidelines for editorial contracts, photographers and photographic agencies 2nd edition
- Best practice guidelines for operating the PPA Mail Order Protection Scheme
- Best practice guidelines for special advertising opportunities within magazines
- Best practice guidelines for vetting advertisement copy
- Standard conditions of acceptance of advertisements
- Best practice guidelines for magazine publishers going online
- Best practice guidelines on lotteries, competitions and free prize draws
- Best practice guidelines for barcoding and issue numbering of magazines
- Best practice guidelines for the effective operation of Presstream
- Best practice guidelines for subscription marketing
- Best practice guidelines for the organisation of work experience placements
- Best practice guidelines for subscription bureaux
- Best practice guidelines for wholesale stock control

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