MAPLES GROUP

UPDATE

Ireland Update: Issues to Consider in Investment Bank Engagement Letters

What You Need to Know

- Many provisions in an investment bank's engagement letter are negotiable.
- Prior to signing an engagement letter, companies should carefully consider and review this important document.

Background

The nature of the relationship between an investment bank and a company in respect of a potential M&A or equity financing transaction is documented in the bank's engagement letter. It is an important document for both parties and should be carefully considered.

We regularly see companies choose not to seek the advice of their lawyers at this point of engagement, believing that these letters are, for the most part, commercial and non-negotiable but later realising they have signed up to onerous terms and conditions. It is true that, like most commercial documents, these letters contain "boilerplate" but there are many provisions which are up for negotiation and need to be reviewed and analysed carefully.

Below we have highlighted the key provisions to be considered.

Services

It is important to review the list of services to confirm alignment on what is to be provided. Many of the services will be the same in every engagement letter such as, reviewing the company's financial position and engaging with acquirers or investors, but the list should be added to depending on the company's needs.

For example, in some cases you might see the scope of services include the management of a data room in connection with the sale or management of the proceeds model.

Management of engagement with counterparties on non-disclosure agreements may also need to be considered as this can be time consuming if there are multiple potential bidders.

Exclusivity and Term

It is usual for the investment bank to be the exclusive advisor for the transaction. A rolling term of between six to twelve months is standard in most cases, but this can vary depending on the complexity of the transaction and / or how much preparation is involved. The company should seek an ability to terminate the engagement for material breach / non-performance prior to that and bring clarity to the implications for any fees in this context.

Keyman

The company should specify whether any member of the investment bank's team is required to lead the project. Routinely, there are problems where the individual the company is looking to as lead leaves the investment bank mid-engagement. Accordingly, the company may seek the right to terminate the engagement if the keyman leaves where an adequate replacement cannot be agreed.

Fee Provisions

Fees

An investment bank will generally require a retainer fee and a success fee. The retainer is usually payable monthly and will often be credited against the success fee. Success fees are usually a simple percentage of a defined transaction or enterprise value or ratcheted percentage of that value.

Success fees are routinely payable on closing. Where there are contingent payments payable following completion (such as escrow, earn-out, etc.) the company can seek to negotiate provisions that the investment bank receives the relevant proportion of its success fee only when / if such amounts are actually paid. Aligning the success fee with receipt of proceeds rather than completion generally only arises where there is uncertainty around consideration.

The company might also seek to list potential buyers that it has begun discussions with prior to engaging the investment bank as being carved out of the transaction fee or as qualifying for a reduced fee.

Transaction Value

Defining transactions value in this context is key. In a majority deal (i.e. change of control) it is usually defined with reference to the enterprise value of the business whereas for a fundraising or a minority deal it is generally defined with reference to the monies invested or consideration received.

It is important to focus on the definition of transaction value because the total fee is generally based on that term. References to bonuses / retention payments / incentive compensation should ideally be excluded from the transaction value.

Expenses

It is typical that investment banks will require the company to reimburse expenses. The types of expenses should be examined as some may fairly be excluded. Expenses should be properly documented with third party receipts. The engagement letter should limit any reimbursement for expenses to reasonable and necessary expenses incurred by the banker. A cap which cannot be exceeded without company approval can also help to avoid unwanted surprises.

Tail Period

A tail period is the post termination period during which the investment bank is still entitled to be paid their success fee where a transaction completes subsequent to the engagement coming to an end. It is intended to mitigate the investment bank's risk where it has assisted a company in preparing for a transaction during the engagement period but a transaction completes shortly after their engagement has ended. A tail period is reasonably standard. However, it is important to bear in mind circumstances in which it is not justified:

- the fee entitlement during the tail period should ideally be limited to transactions involving counterparties which the investment bank introduced to the company during the engagement period; and

- no success fees should be payable if the company terminates the agreement for cause prior to the transaction or where the investment bank itself terminates.

Termination and auto-renewal provisions should be carefully reviewed in this context. Engagement letters can purport to remain in effect indefinitely or, if they have a stated initial term, often automatically renew until affirmatively terminated at the end of the initial or a subsequent renewal term.

In those cases, the tail period will not commence until the engagement letter is correctly

terminated. Care should be taken in the context of failed or aborted processes to ensure that a relevant engagement is terminated.

Term and Termination

Generally, the term of an engagement letter should be no greater than six to twelve months, with an automatic renewal at the end of the specified time frame where services are still being delivered.

Indemnification

It is reasonably standard that the company indemnifies the investment bank and its officers, directors and employees in respect of losses incurred in connection with the engagement.

This, in theory, addresses the risk that the investment bank is the subject of a claim from third parties or shareholders in connection with the engagement.

Generally, there is relatively little room for negotiation in the indemnification provisions. That said carve-outs for wilful misconduct or gross negligence are usual. Companies should consider whether the indemnity should arise where the loss, otherwise subject to the indemnity, arises from the investment bank's own breach.

Parties

Engagement letters are often signed by the company itself but may need to be novated to the shareholders on conclusion of the transactions where shareholders are not party to the engagement letter as issues of privity of contract and loss may arise in the case of default by the investment bank.

How the Maples Group Can Help

If you require assistance or for further information, please reach out to your usual Maples Group contact or any of the persons listed below.

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