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M&A Engagement Letters: Strategies for Buyers, Sellers, Investment Banks and Their Counsel

Negotiating Scope of Engagement, Fees, Confidentiality, Termination, Indemnification and More

THURSDAY, JANUARY 10, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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M&A Engagement Letters: Strategies for Buyers, Sellers, Investment Banks and Their Counsel

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Timing of Engagement

- Often one of the first steps taken by a company pursuing a M&A transaction.
- Investment bank will often require an engagement letter to be signed before it will commence substantive work to ensure there is a clear understanding of the scope and terms of the engagement (but not always the case).
  - In *In re PLX Technology Inc. Stockholders Litigation*, 2018 WL 5018535 (Del. Ch. Oct. 16, 2018), the Delaware Court of Chancery noted its belief that "bankers frequently provide advisory services first and document the engagement letter later."
  - If a full-blown engagement letter cannot be signed before commencement of substantive work, (i) a company will sometimes ask a bank to sign an NDA before commencing work and (ii) a bank will sometimes ask for a short-form indemnification and fee reimbursement agreement before commencing work (or presenting to board).
- Investment bank will typically start with its form engagement letter.

Structure of Engagement Letter

- Transaction Specific Provisions:
  - Identify the client
  - Define the scope of engagement (services provided; transactions covered)
  - Fees and expenses
  - Termination/fee tail
- General Terms:
  - Information provided (confidentiality; company obligations; reliance)
  - Disclosure of advice/opinion
  - Limitations on role/advice
  - Announcement/tombstones
  - Conflicts
  - Indemnification

Scope of Engagement – Who is the Client?

- Identify the client (e.g., the company, board of directors, special committee).
- Investment banks may seek to add additional entities (e.g., subsidiaries, affiliates, entities formed to effect transaction).
- Who pays the investment bank?
  - Generally, if the client is a board or special committee, consider whether any company-related covenants should be the responsibility of the directors, or only the company.

Scope of Engagement – Beneficiary of Advice

- Who is entitled to rely on the investment bank's advice?
- Engagement letters typically include a provision similar to the following: "All opinions, advice and materials provided by Investment Bank is intended solely for the benefit of the Company's [board of directors][special committee][senior management] and may not be relied upon or used by any other person or entity."
- Certain exceptions may be appropriate.
  - Full board entitled to rely on opinion even though special committee is the client.
  - Fee arrangements with other financial advisor.
- Disclosure in SEC filings is permitted.
  - Advisor approval required for summary of opinion.
- SEC comments on limitations on reliance language.

Scope of Engagement – Exclusivity

- Exclusive vs. non-exclusive financial advisor.
  - Investment banks generally want to be the exclusive financial advisor.
  - The company may want to retain an additional financial advisor (e.g., independent fairness opinion, special expertise, potential conflicts).
    - Impact on fees and fee structure
    - Flexibility may be more helpful in committee assignments.
  - Who is subject to exclusivity?
    - Significant shareholders?
    - Majority-owned subsidiaries/JVs/SPVs?

Scope of Engagement – Definition of Transaction

- Broad vs. narrow universe of transactions.
  - Specific parties or any buy-side or sell-side transaction
- Consider whether any carve-outs are appropriate.
  - In company with two or more co-equal divisions, catch a sale of either?
  - Significant shareholders/Majority-owned subsidiaries/JVs/SPVs?
- Important for fees and fee structures.
- Could be viewed by a Court as impacting incentives.
  - In *In re El Paso Corp. Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012), the Court of Chancery suggested an engagement letter that provided a bank a fee on a sale transaction, as opposed to a spin-off, could make advice provided by the bank as to which transaction to consider "more questionable".

Definition of Transaction – Sample Advisor-Friendly Provision

"Transaction" means any transaction or series of transactions whereby, directly or indirectly, control of, or a material interest in, [the Target][the Business] [or any of the Target's businesses or assets] is acquired by, or otherwise transferred to, another person including, without limitation, a sale, acquisition, transfer or exchange of securities or assets, a lease or license of assets (with or without a purchase option) or a merger, consolidation or reorganization, recapitalization or restructuring, minority investment or partnership, joint or collaborative venture, spin-off, split-off, tender or exchange offer, leveraged buyout or other extraordinary corporate transaction or business combination involving [the Target][the Business].

Definition of Transaction – Sample Buyer-Friendly Provision

"Transaction" means any transaction or series of related transactions (other than in the ordinary course of trade or business) whereby, directly or indirectly, more than 50% of the outstanding equity of the Target or all or substantially all of [the businesses and assets of the Target and its subsidiaries taken as a whole][the Business] is acquired by the Company [or any of its affiliates], including, without limitation, a stock acquisition, asset acquisition, merger, consolidation, reorganization, spin-off, split-off, tender or exchange offer, or other similar extraordinary corporate transaction or business combination involving [the Target][the Business].

Scope of Services

- M&A Services
  - Fairness opinion only?
  - Broader financial advisory services?
  - Level of detail in defining specific responsibilities
- Additional Services (e.g., financing, dealer manager, hedging, etc.)
  - Right to pitch or obligation to offer to engage?
  - Fees for additional services?
- Key Persons
- Limitations on Role (agent not fiduciary) and Services (e.g., no tax, legal or accounting services; no financial opinion).

Services to be Provided – Sample Provision

"As part of Investment Bank's engagement, Investment Bank will perform [some or all] of the following services on the Company's behalf [and at the Company's request, if appropriate in the circumstances] in connection with a possible Transaction:

- familiarize itself with the business, operations, financial condition and prospects of the Company;
- assist the [Company][Board][Special Committee] in (i) developing a strategy for pursuing a possible Transaction involving the Company and a list of possible purchasers in the possible Transaction, (ii) preparing an offering memorandum; (iii) contacting and eliciting interest from those possible purchasers **approved in writing by the [Company][Board][Special Committee]**; and (iv) evaluating proposals from possible purchasers;
- participate with the [Company][Board][Special Committee] and its counsel in negotiations relating to the possible Transaction;
- obtain confidentiality agreements (in form and substance satisfactory to the [Company][Board][Special Committee] and its counsel) for possible purchasers prior to the delivery of any non-public information;
- assist the Company's management in preparing and arranging, and participate in, management presentations and facility visits for possible purchasers;
- manage the due diligence process of possible acquirers, including assisting the Company's management in compiling, organizing and managing a data room in connection with a possible Transaction; and
- provide other financial advisory services reasonably necessary to accomplish the foregoing."

Services to be Provided – Sample Opinion Provision

"To the extent requested by the [Company/Board/Committee] in circumstances in which Investment Bank customarily renders an opinion, the Investment Bank agrees to [(i)] be available to meet with the [Company/Board/Committee] to discuss the Transaction and its financial implications [and (ii) render an opinion (the "Opinion") to the [Board/Committee] (solely in its capacity as such) as to the fairness, from a financial point of view, [to the Company][to the Company's stockholders][to the Company's stockholders other than X] [or any other subset of stockholders that the [Board/Committee] reasonably requests to be excluded from such opinion] of the consideration to be paid by the Company in the Transaction (or, in the case of an exchange of securities of the Company, of the exchange ratio), and to furnish to the [Board/Committee] a letter expressing such Opinion]. [Notwithstanding anything to the contrary herein, if requested by the Committee, the Board may receive and rely upon the Opinion.]

Note: ***Helpful To Negotiate Carve outs To Opinion Up Front.***

Additional Services – Sample Advisor-Friendly Provision

"If, during the term of Investment Bank's engagement hereunder or within [●] months after the termination of Investment Bank's engagement [other than as a result of Investment Bank's bad faith, willful misconduct or gross negligence], the Company, on its own behalf or on behalf of its stockholders, proposes or determines to effect any recapitalization, restructuring, acquisition, or an offering or private placement of securities or other similar financing transaction, the Company shall offer to engage Investment Bank as the Company's financial advisor, or exclusive placement agent, as the case may be, in connection with such transaction(s) on terms and conditions customary to Investment Bank for similar transactions; provided, however, that Investment Bank may, in its sole discretion, decline such engagement. The compensation provided to Investment Bank pursuant to such future engagement shall be mutually agreed upon by the parties, and shall be based on, among other factors, the compensation for similar nationally recognized investment firms involved in transactions of similar size, scope, complexity and value, and will be subject to a separate engagement letter with customary terms."

Additional Services – Sample Key Person Provision

"Except as otherwise agreed in writing by the [Company][Board][Special Committee], Investment Bank shall provide the services of [Key Persons] as the Investment Bank directors working on this engagement, so long as they remain employed by Investment Bank or its affiliates. In the event that [Key Persons] are no longer employed by Investment Bank or its affiliates, Investment Bank may use other Investment Bank professionals as it deems appropriate in connection with this engagement."

- Company may seek to limit fee tail if Key Persons leave the Investment Bank.

Limitations on Role – Define Legal Relationship

- Legal relationship: Investment Bank acts solely as independent contractor and not as fiduciary or agent.
  - *Schneider v. Lazard Freres & Co.*, 552 N.Y.S. 2d 571 (N.Y. App. Div 1990): Allegation of fiduciary duties to shareholders led to explicit disclaimers of fiduciary and agency relationships in engagement letters and fairness opinion forms.

Limitations on Role – Sample Provision Defining Legal Relationship

"It is understood and agreed that Investment Bank will act under this letter as an independent contractor with duties solely to the Company and nothing in this letter or the nature of our services in connection with this engagement or otherwise shall be deemed to create a fiduciary duty or fiduciary or agency relationship between us and the Company or its stockholders, employees or creditors, and the Company agrees that it shall not make, and hereby waives, any claim based on an assertion of such a fiduciary duty or relationship. Except as set forth in Annex A hereto [Indemnification Provisions}, nothing in this letter is intended to confer upon any other person (including stockholders, employees or creditors of the Company) any rights or remedies hereunder or by reason hereof."

Limitations on Services – Sample Provision

"Client agrees that Investment Bank is not being engaged to provide, nor shall it be providing or be responsible for providing, legal, tax or accounting advice, or any financial or tax due diligence services. Investment Bank will not be preparing or interpreting any legal documents. It is expressly understood that, with respect to the Services, Investment Bank's reports, recommendations, analyses, conclusions and other documents, if any, whether written or oral, do not, in whole or in part, constitute a [fairness or] solvency opinion or feasibility determination and the Services will be consultative in nature and will not result in the determination of a specific value by Investment Bank. Additionally, Investment Bank will not perform any review, audit or other attestation procedures, with respect to historical or prospective financial information, and will not issue [any opinion or] report or provide any other form of assurance with respect to any financial information in connection with the Services. Investment Bank will not be distributing securities or acting as an agent with respect to the placement of any securities for the benefit of Client or its affiliates."

Fees

- Fee structure/amounts mist be tailored to fit the specific circumstances of each engagement.
- Advisory/Retainer Fee.
  - Generally payable upon execution of engagement letter.
  - May be payable on a periodic basis (e.g., monthly).
  - Usually credited against contingent fees, breakup fees and tail fees.
- Opinion Fee.
  - Payable upon delivery of the opinion (following request).
  - Consider potential opinion updates.
  - May or may not be credited against contingent fees, breakup fees and tail fees.
  - Not contingent upon closing or upon the determination reached in the opinion.

Retainer Fee – Sample Provision

"The Company shall pay to Investment Bank a non-refundable fee of $[●] (the "Retainer"), payable in cash upon execution of this Agreement, plus an additional monthly fee of $[●] ("Monthly Fee") (pro-rated for partial months) until the earlier of (i) the execution of definitive agreements regarding the Transaction and (ii) the [●] month anniversary of the date hereof (and accordingly the maximum Monthly Fees shall be $[●]). Upon the consummation of a Transaction, the Retainer and the aggregate Monthly Fees paid prior to such Transaction shall be credited in full against the Success Fee (as defined herein) and Breakup Fee (as defined herein) payable to Investment Bank in connection with such Transaction."

Opinion Fee – Sample Provision

"Investment Bank shall be entitled to receive, and the Company agrees to pay, a cash fee of $[●], payable upon the earliest of the date following a request of the [Board][Special Committee] for Investment Bank to render an Opinion on which (i) after conducting such analysis as it deems customary and appropriate, Investment Bank advises the [Board][Special Committee] that it will be unable to deliver an Opinion, or (ii) Investment Bank renders an Opinion (regardless of the conclusion therein); payment of which shall be credited in full against the Success Fee and the Breakup Fee;

Fees (cont.)

- Milestone (Interim/Progress) Fees:
  - Payable upon certain interim triggering events (e.g., finalization of a term sheet, execution of a letter of intent/exclusivity agreement, receipt of invitation to participate in next round, execution or announcement of a definitive agreement).
- Transaction (Success) Fee:
  - Payable upon consummation of a Transaction.
  - Fee based on transaction value (often sell-side) vs. fixed fee (often buy-side)?
  - Contingent or future payments (e.g., working capital adjustments, earnouts, employment or bonus-related consideration, escrow disbursements, licensing fees).
    - Investment Bank will seek to include these amounts in definition of transaction value .
    - Company will seek to pay fee based on these amounts when contingencies are satisfied, or adjust these amounts to reflect risk/time.

Contingent Fees

- Contingent Fees incent Investment Bank both to get best price, but also to favor a deal (versus no deal at all).
- Delaware courts have exhibited an understanding of the reasons for contingent fees, but are cognizant of the incentives created, and may require disclosure of the contingent nature of the fees.
- For an example of a Delaware case recognizing incentives created by contingent fee structure, see *In re PLX Technology Inc. Shareholders Litigation*, 2018 WL 5018535 (Del. Ch. Oct. 16, 2018), where the Court of Chancery stated that, "[o]ne factor [that appeared to influence the boardroom dynamic] was [Investment Bank's] contingent fee arrangement, which gave [Investment Bank] a powerful financial incentive to favor a sale over having PLX remain independent."
  - Footnote 511 captures other cases addressing incentives created by contingent fee structure.

Contingent Fees (cont.)

- However, in *In re Oracle Corp. Derivative Litigation*, 2018 WL 1381331, at *14 (Del. Ch. Mar. 19, 2018), the Court of Chancery noted that there was no authority "for the proposition that bad faith may be inferred from a special committee's decision to compensate its financial advisor via a contingent fee arrangement." 2018 WL 1381331, at *14 (Del. Ch. Mar. 19, 2018).
- The Court noted that "the Special Committee here did not blindly agree to pay a contingent fee; instead, it recognized that such an arrangement "would provide the financial advisor with a financial incentive to see a transaction completed[,] and discussed whether there were alternatives to the success fee structure that would best serve [Oracle] and its stockholders."
- The Committee ultimately decided to utilize a contingent fee because:
  - (i): It would be unable to obtain high-quality financial advice unless it was prepared to pay a high fee; and
  - (ii) "[I]t would be more advantageous to [Oracle], on balance, were it not obligated to pay a significant fee for financial advisory services unless and until a transaction were completed."

Disclosures: Compensation Arrangements and Conflicts of Interest

- Recent SEC Staff guidance released on November 18, 2016
  - Outlines the Staff's view of appropriate disclosures with respect to fee arrangements for tender offers
  - General or vague disclosure that investment banks are entitled to "customary fees" is usually insufficient
  - Disclosure should typically include a discussion of the fee structure, including the types of fees and circumstances that will trigger fee payments

Milestone/Progress Fee – Sample Provisions – Buy and Sell Side

"A fee of $[●], payable in cash at the earlier of (i) the signing of a letter of intent, agreement in principle or other similar agreement (whether or not binding on the parties thereto) with respect to a Transaction; (ii) the first public announcement by the Company or any of its affiliates of an intention to commence a tender or exchange offer to acquire all or a substantial portion of the Target's outstanding voting securities; (iii) the mailing of a proxy statement or information statement with respect to a Transaction, and (iv) the date of any action by the stockholders of the Target by written consent or votes cast with respect to a Transaction or an agreement with respect thereto."

"If and when one or more bids are submitted to the Company by potential buyers of the Company and the Company determines to engage in substantive negotiations with respect to a potential Transaction, Investment Bank will be entitled to an additional milestone fee of $[●]."

Transaction Fee – Sample Fixed Fee Provision

"If a Transaction is completed during the term of this Agreement, the Company agrees to pay Investment Bank upon closing of a Transaction, a fee equal to $[●] million."

Transaction Fee – Sample Transaction Value Fee Provision

- "If a Transaction is completed during the term of this Agreement, the Company agrees to pay Investment Bank upon closing of a Transaction, a fee in an amount to be determined according to the following schedule:
  - (i) [●]% of that portion of Transaction Value less than or equal to $[●] million; plus
  - (ii) [●]% of that portion of Transaction Value greater than $[●] million and less than or equal to $[●] million; plus
  - (iii) [●] % of that portion of Transaction Value greater than $[●] million."

Transaction Fee – Sample Definition of Transaction Value

"Transaction Value" means (A) the aggregate amount of cash and the fair market value (determined as set forth below) of any securities or other property or consideration actually received by the Company or its equityholders (in their capacity as such) in connection with a Transaction, plus (B) all indebtedness for borrowed money directly or indirectly assumed, refinanced, retired or extinguished (and all payments made and expenses incurred in connection with the repayment of such indebtedness), less the amount of all cash and cash equivalents held, directly or indirectly, by the Company; plus (C) in the case of a Transaction structured as a sale, transfer, exchange or purchase of equity securities, if less than 100% of the equity of the Company is transferred in the Transaction, the value of any retained interest in the Company based on the value paid for or ascribed to the equity interests transferred in the Transaction; plus (D) in the case of a Transaction structured as a sale, transfer, exchange or disposition of assets, if less than 100% of the assets of the Company are transferred in the Transaction, the fair market value of any assets retained by the Company. For purposes of computing the Transaction Fee, (x) publicly-traded securities shall be valued at the average of their [4:00] p.m. closing prices (as reported in The Wall Street Journal) for the [two] trading days prior to the date which is two business days prior to the date of Closing of the Transaction and (y) any other non-cash consideration shall be valued at the fair market value thereof as determined in good faith by the Company and Investment Bank.

Fees (cont.)

- Alternative Transaction Fee
  - Payable upon consummation of a transaction that does not qualify as a Transaction (e.g., a sale of less than 50% of the outstanding equity)
- Termination (Break-Up) Fee
  - Payable upon receipt by the Company of a break-up fee in connection with the termination of the definitive agreement
- Tail Fee
  - Payable if a transaction is entered into during a period of time following termination of the engagement (and subsequently closes, even if outside such period)
- Additional Services Fee
  - Depends on likelihood that additional services will occur
  - Parties may mutually agree to fee at later date

Alternative Transaction Fee – Sample Provision

"In the event the Transaction involves a transfer of ownership or control of less than 50% of the then-outstanding voting securities of the Target, no significant interest in any of its businesses or assets or an Alternative Transaction (as defined below), the fee payable to the Investment Bank shall be a fee that would customarily be paid to a nationally recognized investment bank engaged as a financial advisor in connection with a comparable transaction.

The term "Alternative Transaction" shall include any transaction or series of related transactions involving the Company or any of its affiliates on the one hand and [the Target] [the Business] or any of their affiliates or any of their respective shareholders on the other hand, that does not constitute a Transaction (an "Alternative Transaction").

Termination Fee – Sample Provision

"If, following or in connection with the termination, abandonment or failure to occur of any proposed Transaction in respect of which the Company entered into an agreement during the term of this Agreement, the Company or any affiliate is entitled to receive a break-up, termination, "topping," expense reimbursement, earnest money payment or similar fee or payment (including, without limitation, any judgment for damages or amount in settlement of any dispute as a result of such termination, abandonment or failure to occur) (each and together, "Termination Payments"), Investment Bank shall be entitled to a cash fee (the "Break-Up Fee") (net of any unreimbursed costs and expenses incurred by the Company in obtaining such amount), payable promptly following the Company's or such affiliate's receipt of such amount, equal to [●]% of the aggregate amount of all Termination Payments paid to the Company or such affiliate; provided, however, that the Break-Up Fee shall not be greater than the Transaction Fee that would have been payable had the proposed Transaction been consummated."

Tail Fee – Sample Provision – Seller Friendly

In the case of termination by the [Company][Board][Special Committee] other than as a result of our bad faith, willful misconduct or gross negligence, or any expiration of our engagement, we shall remain entitled to full payment of all fees contemplated hereby in respect of any Transaction consummated during the period from the date hereof until twelve months following such termination or expiration (as the case may be, the "Tail Period") or in respect of any Transaction subsequently consummated if a definitive agreement resulting in such Transaction is entered into during the term of this engagement or such Tail Period; provided, however, that, if, following such expiration or termination, the [Company][Board][Special Committee] offers in writing to renew our engagement under the terms of this Agreement and we decline such reengagement then the Company shall not be required to pay such fees.

Additional Services Fee – Sample Provision

"To the extent Investment Bank is requested by the Company to perform any services which are not within the scope of this engagement (such as rendering a fairness opinion), the Company shall pay Investment Bank such fees as shall be mutually agreed upon by the parties hereto in writing, in advance, depending on the level and type of services required, and shall be in addition to the fees and expenses described hereinabove. Except as set forth in the preceding sentence, if Investment Bank is required to produce documents, answer interrogatories, attend depositions, and testify at trial (whether by subpoena, court process or order, or otherwise), the Company shall pay Investment Bank's then current hourly rates for the persons involved for the time expended in rendering such services, including, but not limited to, time for meetings, conferences, preparation and travel, and all related reasonable and documented out-of-pocket expenses (including, without limitation, the reasonable and documented fees and expenses of Investment Bank's legal counsel incurred in connection therewith)."

Agreement to Agree on Fees

- Tail, alternate transaction and additional services fees can be defined or unspecified ("…shall be mutually acceptable . . . and consistent with compensation agreements customarily agreed to by" advisors for similar transactions.").
- *Cowen & Co. v. Fiserv, Inc.*, 31 N.Y.S.3d 494 (2016): A fee provision which required a "fee run" and a comparable transactions analysis was enforceable because the fee due could be "ascertained by public price indices and industry practice".
  - Evidence showed parties had discussed comparable transactions and percentages at the time of negotiation.
- *Stone Key Partners LLC v. Monster Worldwide, Inc.*, Case No. 1:17-cv-3851 (S.D.N.Y. Aug. 10, 2018): The tail period fee provision was too indefinite to be enforceable because:
  - It contained no mechanism by which the fee could be objectively calculated, and
  - It required a "new expression" of "mutual acceptab[ility]" by the parties
  - Further negotiations would have been required
  - The parties never discussed any fees for a tail-period transaction, much less how such a fee would be calculated
- Post-*Stone Key*: To have an enforceable agreement-to-agree, build in greater specificity as to the parameters of the fee run or factors to be considered and other objective benchmarks such as minimum percentages or fee floors, but note that the more specificity (and more enforceable) the less potential upside from an open-ended agreement-to-agree.

Expense Reimbursement

- Generally payable upon receipt of invoice or upon request.
- Typically subject to a cap or required notice to the Company before exceeding specified threshold.
- Certain expenses may be treated differently (e.g., legal costs).
- Limitations on expense reimbursement should not affect or limit the Company's indemnification obligations.

Expenses – Sample Provision

"In addition to any fees payable to Investment Bank hereunder and regardless of whether or not a Transaction is consummated, the Company hereby agrees, from time to time upon written request, and upon expiration or termination of the Term, to reimburse Investment Bank for all actual, documented, reasonable travel and other out-of-pocket expenses incurred in connection with Investment Bank's engagement hereunder, including the reasonable fees and expenses of Investment Bank's outside counsel (related to the Transaction, and not this Agreement), provided that Investment Bank shall not incur expenses in excess of $[●] in the aggregate absent the prior written consent of the [Company][Board][Special Committee] (which shall not be unreasonably withheld), provided that any such limitation shall in no way affect or limit the obligations of the Company as set forth on Annex A attached hereto."

Conflicts of Interest

- Examples of financial advisor conflicts
  - Investment bank has a relationship with, or financial interest in, the counterparty.
  - Seller's investment bank provides buy-side financing.
  - Fee structure (i.e., milestone and transaction fees).
  - Personal relationships with senior management or board members.
- Why do we care?
  - Risk of breach of fiduciary duty for board members.
  - Disclosure obligations to stockholders.
  - Deal timing and protections could be impacted.
  - Buyer could end up with the liability.
  - Investment bank could also become liable.

The Arc of Conflict Cases - Delaware

- There have been a number of Delaware cases examining banker conflicts in the M&A context spanning many decades.
- Historically, most cases were focused on the adequacy of the disclosures to stockholders relating to banker conflicts.
- From the mid-2000's – mid-2010's, there was greater emphasis on whether the board breached its fiduciary duties in hiring and relying on a conflicted advisor and whether conflicted advisors would face liability for aiding and abetting a fiduciary duty breach.
  - E.g., *Toys R Us, Del Monte, Rural Metro, El Paso, Zale, PLX*.

The Arc of Conflict Cases – Delaware (cont.)

- Following *Rural Metro*, there was discussion of whether potential conflicts ought be the subject of representations and warranties in the engagement letter.
  - Klinger-Wilensky/Emeritz Business Lawyer Article: "Financial Advisor Engagement Letters: Post-Rural/Metro Thoughts and Observations".
- Practice has generally settled around disclosure memorandum being provided to the Board or Committee at the outset of the engagement (or at an appropriate stage in the process when counterparties are likely to be identifiable), rather than the use of representations and warranties.
- Through the presentation and negotiation of the disclosure memorandum, potential conflicts are brought to the attention of the Board / special committee.
  - Potential conflicts are not necessarily disqualifying; this process is designed to provide a process for the Board/special committee to vet potential conflicts and determine for itself whether they are disqualifying.

Reference to Disclosure Memorandum – Sample Provision

"Investment Bank has provided to the [Board][Special Committee] a disclosure memorandum (a "Disclosure Memorandum"), in its typical form, setting forth the general nature of the Investment Bank's relationships, if any, currently existing or that existed during the previous [two][three] years between Investment Bank (including disclosure with respect to the managing directors on Investment Bank's investment banking team assigned by Investment Bank to provide services to the [Board][Special Committee] with respect to this engagement (the "Deal Team")), on the one hand, and the Company, [Identify Other Parties] (collectively, the "Relevant Parties"), on the other hand."

"Investment Bank will, from time to time during the term of this agreement upon the reasonable written request of the [Board][Special Committee] provide an updated Disclosure Memorandum to the [Board][Special Committee], which shall include updated disclosure with respect to the current Relevant Parties and / or similar disclosure with respect to potential Transaction partners identified by the Special Committee in its written request (and, following such request, such potential Transaction partners shall be "Relevant Parties" for purposes of this Agreement).

Items Potentially Included in Disclosure Memorandum

- Disclosure Memorandum forms are not uniform between and within Investment Banks and modified to address specific concerns or include more or less information as maybe appropriate under the circumstances.
- Typical focus of Disclosure Memorandum:
  - Work performed for, and aggregate compensation received from, Relevant Parties during [two][three] year period prior to engagement.
  - Investments (debt or equity) in, or co-investments with, Relevant Parties by Investment Bank and deal team members.
  - Prior pitches including financial information regarding the Company made to Relevant Parties.

Restricting Services?

- Company may wish to restrict new engagements that the Investment Bank may take on for Relevant Parties during the term of the engagement.
  - May be more relevant for committee assignments than Company assignments.
- Restrictions may be limited to providing advice or financing with respect to the particular transaction, or may be broader in scope.
  - If broader in scope, restrictions may be limited to members of the deal team, rather than the full Investment Bank.

Restricted Services – Sample Provisions

Narrow - "Investment Bank shall: (i) not act as a buy-side M&A (and/or financial) advisor to any counterparty in a Sale and (ii) not agree to provide new acquisition financing to a proposed acquirer with respect to a Transaction without the [Board's][Special Committee's] prior written consent, [which consent shall not be unreasonably withheld]."

Intermediate – "(i) Investment Bank shall not provide financial advisory services to any potential Transaction partner or Relevant Party in connection with a Transaction, (ii) no member of the Deal Team shall provide financial advisory services to any Relevant Party, whether or not in connection with a Transaction and (iii) the Deal Team shall inform the [Board][Special Committee] if any member thereof acquires knowledge of an engagement of Investment Bank for the provision of financial advisory services to any Relevant Party."

Broad - "Notwithstanding anything herein to the contrary, during the term of this engagement, Investment Bank shall not provide M&A advisory services, new debt or equity capital markets or new bank financing to any Relevant Party without the prior written consent of the [Board][Special Committee]."

Aiding and Abetting – Delaware Emphasizes Scienter Requirement

- *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016):
  - Court is skeptical about inference of scienter based on the advisor's late disclosure of a potential conflict of interest due to a prior pitch.
  - "Delaware has provided advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter… [and the scienter requirement] awards advisors an effective immunity from [their own lack of due care]."
- *In re Xara Inc. S'holder Litig.*, 2018 WL 6498677 (Del. Ch. Dec. 10, 2018):
  - Latest example of Court rejected aiding and abetting claim, in this case against buyer.
  - "The knowledge standard embedded in our aiding and abetting law is a stringent one, one that turns on proof of scienter of the alleged abettor."

Information

- Company required to provide Investment Bank with access to all relevant information regarding transaction participants and access to personnel.
- Investment Bank entitled to rely on all information provided to or discussed with it or available from public sources.
- Entitled to assume projections are reasonable.
- Company obligation to notify Investment Bank if there are any material misstatements / omissions in information previously provided.
- Investment Bank has no obligation to independently investigate or verify such information.

Confidentiality

- Confidentiality provisions may be included in the engagement letter or set forth in a separate agreement
- Typically the investment bank's right to use or disclose information it receives about the client or the target will be limited to the scope of the engagement, subject to standard confidentiality exceptions
- Duration of confidentiality period depends on type of discloser (private vs. public co.) and type of information
- The client should ensure that the investment bank's confidentiality obligations coincide with the confidentiality agreement between the client and counterparty to transaction (e.g., term, confidentiality exceptions)
- The client may request that the investment bank negotiate and enter into confidentiality agreements with third parties (in form and substance satisfactory to the client)

Confidentiality (cont.)

- Investment Banks will typically ask that information regarding their fairness opinion remain confidential. Parties will typically negotiate one or more of the following exceptions:
  - Disclosure of any materials that relate to tax treatment or tax structure.
  - Reproducing the opinion and related analysis in public filings (subject to consent right of Investment Bank).
  - Utilization of opinion in transaction litigation.

Confidentiality – Sample Exclusions

Notwithstanding the foregoing, the Company may: (i) disclose the tax treatment and tax structure of a Transaction and the portions of any materials that relate to such tax treatment or tax structure and (ii) reproduce the Opinion in full together with a description of the material financial analyses underlying such Opinion (in form and substance as Investment Bank shall approve[, such approval not to be unreasonably withheld, conditioned or delayed]), in any statement on Schedule 14D-9 or proxy statement relating to a Transaction that the Company is required to file under the Securities Exchange Act of 1934, as amended."

"In addition, Company and its directors shall each be entitled to utilize and disclose the Opinion and the final presentation delivered in conjunction with the Opinion in connection with the defense of any action, suit or proceeding relating to the Transaction with prior consultation with the Investment Bank to the extent practicable."

Termination

- Typically either party may terminate the engagement at any time with or without cause by giving notice to the other party
- Certain obligations survive termination (e.g., payment of accrued fees and reimbursement of accrued expenses, Transaction Fee during tail period, indemnification)
- As reflected in sample tail fee provision, There may be certain exceptions to the payment of fees in the event of the investment bank's breach, gross negligence, etc.
- *Stone Key Partners LLC v. Monster Worldwide, Inc.*, Case No. 1:17-cv-3851 (S.D.N.Y. Aug. 10, 2018): Court relied on extrinsic evidence to find that the engagement ended when it was clear the sale exploration process was over, rejecting Stone Key's arguments that the engagement letter unambiguously provided that the engagement ended only if a sale transaction was executed or written notice of termination was given.

Indemnification and Related Obligations

- Typically in customary form and set forth on a schedule/exhibit/annex to engagement letter.
  - Broad indemnification with reimbursement of expenses.
  - Contribution clause if indemnification is unenforceable.
  - Exculpation clause.
- Most large Investment Banks require in-house legal sign-off for negotiated changes to indemnification provisions.
- Limited carve-outs (e.g., losses that are finally judicially determined to have resulted from the Investment Bank's gross negligence, willful misconduct or bad faith).
- Will Investment Bank have consent right over settlements?

Indemnification and Expense Reimbursement – Sample Provision

"In consideration of the Agreement, you agree to (i) indemnify and hold harmless us, our Affiliates, and each of their respective partners, directors, officers, agents, employees and controlling persons (each of Investment Bank and such other person or entity is hereinafter referred to as an "Indemnified Person"), from and against any losses, claims, damages, liabilities and out-of-pocket expenses, including any such amounts assessed against multiple parties to the extent any such parties are Indemnified Persons, and all actions, inquiries, proceedings and investigations in respect thereof, to which any Indemnified Person becomes subject or involved in any capacity arising out of or in connection with the performance of our duties under the Agreement, regardless of whether any of such Indemnified Persons is a party thereto, and (ii) periodically upon written request, including all supporting documentation, reimburse an Indemnified Person for such person's reasonable and out-of-pocket legal and other out-of-pocket expenses as are incurred in connection with investigating, preparing, defending, paying, settling or compromising any such action, inquiry, proceeding or investigation, whether or not such action, inquiry, proceeding or investigation is initiated or brought by any person, including your creditors or stockholders. You are not responsible under clause (i) or (ii) of the foregoing sentence for any losses, claims, damages, liabilities or expenses to the extent that such loss, claim, damage, liability or expense has been finally judicially determined to have resulted from actions taken or omitted to be taken by any Indemnified Person due to any Indemnified Person's gross negligence, willful misconduct or bad faith."

Contribution – Sample Provision

"If, for any reason (other than by reason of a final, non-appealable judgment by a court as to the gross negligence or willful misconduct of Investment Bank as provided above) the foregoing indemnity is judicially determined to be unavailable to an Indemnified Person for any reason or insufficient to hold any Indemnified Person harmless, then the Company agrees to contribute to any such Losses in such proportion as is appropriate to reflect [both] the relative benefits received or proposed to be received by the Company and its securityholders, on the one hand, and by Investment Bank, on the other, from the Transaction or proposed Transaction [and][or, if allocation on that basis is not permitted under applicable law, in such proportion as is appropriate to reflect not only the relative benefits received by the Company and its securityholders, on the one hand, and Investment Bank, on the other, but also] the relative fault of the Company and its securityholders on the one hand, and Investment Bank, on the other, as well as any relevant equitable considerations. Notwithstanding the provisions hereof, the aggregate contribution of all Indemnified Persons to all Losses shall not exceed the amount of fees actually received by Investment Bank with respect to the services rendered pursuant to the Agreement. Relative benefits to the Company and its securityholders, on the one hand, and to Investment Bank, on the other hand, shall be deemed to be in the same proportion as (i) the total transaction value of the Transaction or the proposed Transaction bears to (ii) all fees actually received by Investment Bank in connection with the Agreement."

Exculpation – Sample Provision

"The Company agrees that no Indemnified Person shall have any liability to the Company or its owners, parents, affiliates, securityholders or creditors for any Losses, except to the extent such Losses are determined, by a final, non-appealable judgment by a court, to have resulted solely from arising out of Investment Bank's gross negligence or willful misconduct (other than an action or failure to act undertaken at the request or with the consent of the Company)."

Dispute Resolution

- Arbitration vs. litigation
- Preferred venue for disputes
- Treatment of different types of disputes (e.g., fee disputes)