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Structuring M&A Representation with Investment Bankers

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Constructing the correct agreement with your investment banker will protect your interests while encouraging the investment banker to represent you best.

Compensation for your investment banker may consist of:

- An initial retainer that may in some cases be credited totally or partially against the success fee
- A monthly retainer
- A success fee contingent on closing the transaction

In negotiating fees, consider carefully the range of services the investment banker will perform.

Exclusivity is an important consideration that investment bankers believe will enable them to obtain the best deal for their clients.

Principals in M&A transactions today will likely utilize the services of an investment banker. Most seasoned executives are well aware that a good investment banker plays a critical role in the team of professionals for their company's purchase or sale transaction. However, what many purchasers or sellers may not understand is how to structure their investment banking agreements so that their interests are best presented and protected. These agreements contain many nuances that actually play out during the transaction process and could cause the purchase or sale to be less than successful even if a satisfactory price is otherwise obtained. Buyers and sellers should work with an experienced transactional attorney, who can assist in structuring the investment banking agreement, help the company understand its nuances, and advise which terms should, or should not, be negotiated.

There are several important items that the company and the investment banker must decide in their agreement. An initial issue is whether the company must pay the investment banker an initial or monthly retainer before it begins work. This amount is in addition to, and is smaller than, the fee received upon closing the transaction. As with many professionals, investment bankers as a rule ask for a retainer for several reasons, such as confirming that the company is serious about a transaction and has some "skin in the game," inducing a commitment to respond promptly to the investment banker's requests for information, and providing some compensation to the investment banker for its services in preparing for the transaction. Whether the retainer takes the form of an initial or monthly fee can be determined by the services that the investment banker intends to perform. For example, an investment banker may charge monthly fees representing buyers in searching for suitable sellers or representing sellers requiring significant advisory services before the seller is ready for market. Many sellers object to paying retainers because, from their perspective, an investment banking firm which is confident of their ability to deliver a transaction arguably should not need a retainer. One alternative arrangement is to have initial retainers credited, totally or partially, against the success fee, whereas monthly retainers, which reduce the initial expense to the company, generally are not credited.

Exclusivity is another issue. Investment bankers often spend significant time preparing a company for a transaction, such as helping a seller clean up potential problems, creating an offering book, and searching for the transaction partner. Investment bankers do not want to put their effort and credibility into this process if somebody else can make an introduction which results in a deal but also results in the investment banker not earning their success fee. Investment

bankers also believe that, without exclusivity, they cannot control other persons shopping the deal, and indiscriminate shopping makes the investment banker and company appear overanxious and insincere. On the other hand, some companies believe that, for an investment banker to earn a success fee, the investment banker should bring the other party to the transaction. Sellers sometime seek to carve out from the agreement specified buyers with whom they have a relationship. However, doing so leaves those buyers out of the investment banker's competitive process and thus does not allow the investment banker's efforts to come to bear on these potentially well qualified buyers. Alternatives to exclusivity include paying larger initial and/or monthly retainers or paying the investment banker a smaller success fee if the ultimate buyer was identified by the seller prior to the engagement.

The timing of payment of success fees is a frequently negotiated point, especially if the transaction involves deferred payments such as contingent or future payments or notes.

A critical deal point which transactional attorneys frequently negotiate is how and when the company pays success fees. Investment bankers typically create a success fee structure that is based on a percentage of the overall value of the deal, often with the percentage being tiered (up or down) as the overall deal size increases. Sellers generally try to pay the investment banker only when the seller receives cash, both at closing and when it receives any deferred payments (such as contingent or future payments, payments on buyer's notes received, etc.), whereas generally investment bankers would like to receive the total transaction value at closing, regardless of when all of the cash is received. One way the investment banker and seller can resolve this issue is by agreeing to assign at closing a net present cash value of the future cash stream on deferred payments and paying the success fee on that amount as well as the cash received at closing. Buyers face a similar issue with investment bankers in determining the deal value when there are contingent future payments or earn outs or when the seller executes non-compete agreements.

Other issues to consider include:

- Levels of representations, warranties, and indemnifications between a seller, a buyer, and the investment banker
- Your company's payment responsibility to the investment banker if you conclude a transaction after the investment banking agreement terminates

There are several other issues that the company and the investment banker must consider. For example, what level of representations, warranties, and indemnification a seller must provide to the buyer and the investment banker. Another is whether the company must pay the investment banker if, after the investment banking agreement terminates, the company concludes a transaction with buyers that were introduced to the company during the agreement's term, and, if so, for how long this obligation continues (the "tail").

Managing a successful transaction is time consuming and can distract management from the day-to-day running of the company. Your team of outside advisors can help minimize the disruption.

Having a well negotiated agreement with your investment banker is only one step in effectively managing an M&A transaction. Executives with transaction experience understand that managing a successful transaction is time consuming and can be a big distraction to their company's operations. For example, a significant reason that many transactions fail to close is when the seller's financial performance declines during the transaction process because its executives are too consumed with negotiating and managing the deal. The investment bankers and transactional attorneys can minimize, as much as possible, the disruption to the day-to-day business of the client. Working together with the company's tax and other financial advisors, the investment bankers and transactional attorneys provide the core team of outside advisors who assist the company with valuing and structuring the proposed deal and ultimately negotiating the best possible financial and legal structure for their client.



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