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Engagement Letter Best Practices - Part One

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One of the first steps a company (the **Issuer**) seeking to raise funding in the exempt market will take is the formal written engagement of an Exempt Market Dealer (the **EMD**) pursuant to an Engagement Letter. The Engagement Letter is typically in the EMD's "standard form" and will as a matter of course deal with, amongst other things, issues such as the Nature of the Engagement, Scope of Services, Compensation, Reimbursement of Expenses, Information Exchange, Indemnification and Public Announcements. While in our experience, the entering into of an Engagement Letter tends to be somewhat perfunctory, a number of critical issues should be dealt with as a matter of "best practice" by an EMD. Over the next few issues of the Exempt Market Update, we will outline a number of recommended 'best practices" for EMD's and their Engagement Letters.

Best Practice #1 - Clearly identify the Nature of the Engagement: Exclusive, Non-Exclusive, Non-Exclusive with Protected List or Limited Protected List

The Engagement Letter should **clearly set out** whether the EMD's engagement by the Issuer is in the nature of exclusive (i.e. the Issuer may not retain the services of any other EMD during the term), non-exclusive (i.e. the EMD **may** retain the services of other EMD's during the term) or non-exclusive with a protected list (i.e. the Issuer may engage the services of other EMD's during the term, but the EMD will be protected in terms of compensation for those investors identified on the Protected List). The practical consequence of not clearly setting out that the nature of the Engagement will in all likelihood lead to the Engagement being deemed to be non-exclusive, with the ability of the EMD to engage other EMD's during the term of the Engagement Letter and compensation being paid to the first EMD only for those investors it introduces and for which there is a closing during the term.

Alternatively, a properly drafted exclusive mandate will entitle the EMD to exclusive representation of the Issuer during the term of the Engagement Letter and the right to receive compensation for any amounts raised during the term, howsoever the investment is procured (i.e. compensation whether the EMD introduces or procures the investor or the investor comes from another source without the EMD's involvement). It is also critical in drafting an exclusive Engagement Letter that the exclusivity terms be consistent throughout the entire agreement.

Very often we see Engagement Letters that are internally inconsistent in their terms, namely, the "Engagement" section of the Engagement Letter appoints the EMD on an "exclusive" basis, but the Compensation section of the Engagement Letter speaks to the EMD being compensated for amounts "raised by the EMD". This is sub-optimal drafting as "amounts raised by the EMD" implies the EMD must actually source the investor and be, in the words of courts who have considered the issue, the "procuring cause"of the investment, whereas in a properly drafted exclusive mandate, the EMD should be compensated for any amounts received by the Issuer during the term of the Engagement Letter, whether the EMD is the "procuring cause" of the investment or not.

The Non-Exclusive with Protected List mandate is a hybrid, occupying the middle ground between the Exclusive and Non-exclusive mandate, whereby the Issuer is free to retain the services of other EMD's during the term of the Engagement Letter, but the EMD will only be compensated on a success basis for those investors for whom it is either the procuring cause and who are not identified on the Protected List and compensation will also flow for those investors who are specifically identified on the Protected List (the Protected List usually being appended to the Engagement Letter).

A slight variation to the foregoing is called the Limited Protected List mandate, which does not confer any mandate on the EMD other than to solicit those investors specifically identified on the Protected List. This type of mandate is often used to bridge the gap where the EMD has no pre-existing relationship with the Issuer, is approaching the Issuer for a mandate because the EMD believes it can source funding from a specified investor and the Issuer is leery to confer a mandate on the EMD, other than a limited one to approach the EMD's specified investor(s) on the Protected List.

In all circumstances, whether Exclusive, Non-Exclusive, Non-Exclusive with Protected List or Limited Protected List, best practice dictates that the nature of the mandate be clearly set out in writing in the Engagement Letter. Do not leave it vague and specifically use the terminology in the Engagement Letter that references "exclusive", "non-exclusive" or "non-exclusive with a Protected List and the like. In addition, it is important to make sure the Engagement Letter is internally consistent as between the nature of the mandate (i.e. exclusive / non-exclusive or protected list) and the other sections of the agreement, especially the EMD's "Compensation" provisions.

Negotiation Tip

In our experience, unsophisticated or first-time Issuers sometimes just assume that a non-exclusive engagement is necessarily in their best interests and try at the outset of the negotiation of the Engagement Letter to resist an exclusive engagement - this on the theory that a non-exclusive Engagement provides the Issuer more flexibility in terms of allowing the Issuer, should it decide, to engage more "feet on the street" to raise capital through various EMD's simultaneously. I believe this is an incorrect assumption, which in many cases can and should be refuted.

Optimal results of a fundraising exercise are typically achieved by the EMD when (a) the EMD has a proven track record of raising capital in the Issuer's particular industry domain (i.e. mining, high tech, manufacturing, biotech etc, etc) and (b) the EMD is in a position to create a professional, co-ordinated and controlled auction for the investment opportunity.

Nothing could we worse for an offering than the "deal collision" that results when two different EMD's approach the same investor at the same time, or a scattered or shotgun approach to marketing through uncoordinated efforts is engaged in, which risks the impression of disorganization at best and desperation at worst. Experience teaches that an Issuer and its EMD only have one chance with a potential investor to make a good first impression and as such, an uncoordinated, duplicative marketing approach, which can result from two EMD's engaged simultaneously, rightly or wrongly often reflects poorly on the investment opportunity itself. This should be clearly explained to the Issuer.

Next Issue - Part Two: Best Practices when drafting "Fee-Tails" in EMD Engagement Letters.

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