SEYFARTH SHAW LLP
ATTORNEYS
One Minute Memo™
Timely Information for Busy Professionals

July 21, 2005

Ambiguous Tail Provisions in Investment Banking Engagement Letters May Sacrifice Success Fees

A recent state appeals court decision highlights the importance of drafting unambiguous tail provisions to avoid litigating over fees. In *William Blair and Co. v. FI Liquidation Corp.*, an Illinois appellate court held that a tail provision in an engagement letter left in doubt whether a company owed a success fee to an investment banking firm for work it had done to introduce the company to its eventual buyer. Because the provision's ambiguity left issues of material fact in contention, the appeals court held that the investment bank could pursue the disputed fees in a trial court — a costly and time-consuming proposition that could have been avoided.

The Ambiguous Tail Provision

In 1995, Spectra Graphics, a printing company now known as FI Liquidation Corp., contacted Blair, an investment banking firm, to arrange Spectra's sale to, or merger with, another company. Blair first presented Spectra with its standard engagement letter, whereby Spectra would agree to pay Blair a retainer fee plus a success fee, i.e., a percentage of the consideration Spectra received for any successfully consummated transaction. The engagement letter also included a "tail provision," which provided that either party could terminate the relationship, but if within twelve months of the termination Spectra consummated a transaction with a company with which Blair had "discussions" on Spectra's behalf, then Blair was entitled to full payment of the success fee.

Spectra negotiated the terms of the tail provision, adding the word "substantive" before "discussions," which would appear to have created a higher hurdle for Blair to jump before success fees would be paid. Just how high that hurdle was raised, however, is still being disputed in the courts because the language used was vague according to the Illinois appellate court.

The Disputed Fees

After signing the revised engagement letter, Blair began its work by preparing a "confidential descriptive memorandum" (CDM) to generate prospective purchasers' interest in Spectra. Blair then contacted approximately fifty companies to gauge their interest. Twenty-five companies, including G.T.C. Transcontinental Group, Ltd. ("Transcontinental"), expressed interest, negotiated and signed confidentiality agreements, and received CDMs. Subsequently, Blair employees engaged in follow-up procedures, but no transaction transpired at that time.

Spectra eventually terminated its relationship with Blair and hired another investment banking firm, which then contacted Transcontinental; Transcontinental subsequently acquired Spectra, and Spectra paid a success fee to the new firm. After learning of the acquisition, Blair demanded payment under its tail provision with Spectra. When Spectra refused, Blair filed suit.

Blair contended that the work it engaged in satisfied the "substantive discussions" requirement of the tail provision, entitling it to a success fee. Spectra argued that Blair made "merely preliminary steps" that did not trigger the tail provision because they were not "substantive," and that the tail provision required more substantial work, such as extensive due diligence, negotiation of a letter of intent, multiple meetings over the course of weeks, and/or drafting of a purchase agreement.

What Are "Substantive Discussions?"

The court held that the term "substantive discussions" was ambiguous both in its plain dictionary meaning and as set forth in the engagement letter itself. Because the parties had not agreed to a definition of "substantive," and the appeals court found that dictionary definitions were themselves ambiguous, it remanded the case to the district court for trial of the issues.

Conclusion

If tail provisions are drafted carefully to weed out ambiguity, costly litigation can be avoided. Working with counsel to prepare engagement letters that are clear will help to assure payment of the fees due.

If you have any questions concerning tail provisions, please contact the Seyfarth Shaw LLP attorney with whom you work or any attorney on the website at www.seyfarth.com.

SEYFARTH ATTORNEYS SHAW LLP

Breadth. Depth. **Results.**