

JP MORGAN LOSES ON MANDATE FEES – DRAFTING COMES ADRIFT

Brett Cowell
Chairman of Partners

“Plain English” or “commercial language” drafting has had a costly outcome for the investment banker, JP Morgan, which lost its claim to be paid increased defence fees in the takeover of Consolidated Minerals by Palmary Enterprises following a bidding war in 2008. JP Morgan had been paid \$20m but was seeking another \$30m for its part in the defence of ConsMin. The unanimous NSW Court of Appeal decision on 8 February 2011 turned on technical interpretations of a number of provisions in JP Morgan’s engagement letter (mandate) and shows how important it can be that the terms of engagement are very clearly spelt out. JP Morgan had said the mandate used the language of bankers and the Court found some of its keys terms were not drafted with sufficient precision to achieve what JP Morgan wanted.

Three key terms of the mandate were especially in question:

1. a "base defence response fee" was to be calculated as a percentage of “transaction value”;
2. an "incentive fee" was payable by reference to the increase in price at which a transaction completed as compared to the initial offer price;
3. the "base defence response fee" was payable if an offer was “successfully defended”.

Transaction value

The base defence response fee was to be calculated as a percentage of the transaction value. In summary, the mandate defined the transaction value as being the total proceeds and other consideration paid or contributed “in connection with the Offer”.

As often happens, prior to its bid, Palmary had acquired a substantial stake (14.29%) in ConsMin at considerable cost. JP Morgan said that cost should be included as part of the amount Palmary had paid “in connection with the Offer”. The Court disagreed. It held that that cost was incurred in anticipation of its takeover offer being made but that it wasn’t in connection with the “Offer” that resulted in the successful takeover.

If JP Morgan wanted the cost of acquiring a pre-bid stake to be included in the “transaction value” for the purpose of calculating its fee, the mandate should clearly have said so.

Incentive fee

The mandate entitled JP Morgan to an additional incentive fee which was to be calculated as a percentage of "any increase in the Offer price ... above the initial Offer price". Pallinghurst Resources Australia had made the initial unsolicited bid for ConsMin. Territory Resources then made a bid and in the process, a number of competitive bids made. Finally, a bid by Palmary was successful.

The parties disagreed about what constituted the "initial Offer price" when calculating the increase in the Offer price, given that there were several offer prices in the course of the whole process. Pallinghurst’s first bid was at \$2.08 per share. There were then a number of higher bids culminating in Palmary’s successful final bid of \$5.00 per share.

JP Morgan contended that the difference between \$5.00 and \$2.08 was the relevant increase for calculating the incentive fee. ConsMin said that the increase between Palmary's initial and final offer prices was relevant. Palmary's first offer was at \$3.95 per share.

The Court adopted a very technical approach to interpreting the relevant terms in the mandate. It found that only the difference between Palmary's initial and final offer prices could be used to calculate the incentive fee. Faced with competing interpretation arguments, the Court did what it was bound to do – it determined the intention of the parties by looking carefully at what the parties had agreed to in writing.

In a potential takeover situation, if directors consider that an initial offer is inadequate, one quite common response is to go to a competitive auction process. Incentive fees to investment bankers based on the increase in offer prices are often built into defence mandates. Most advisors would probably have thought that the difference between the initial and the final offer prices, whether from the same or from different bidders, was the basis for calculating the incentive payment. Again, the message is to ensure that the mandate is clearly drafted.

Base defence response fee

JP Morgan claimed that if it was unsuccessful on the first 2 grounds (which it was) it was entitled to base defence response fees in respect of each competitive offer preceding the ultimately successfully Palmary bid on the basis, it said, that those bids were all "successfully defended".

The relevant term in the mandate provided that a base defence response fee was payable in relation to an offer which either:

- resulted in a completed takeover, merger or other business combination being effected between the Company and the bidder; or
- was successfully defended by the Company in circumstances where the majority of directors of the Company recommend to shareholders that they reject the offer or otherwise determined to defend the offer.

The final Palmary offer resulted in a takeover of ConsMin. The parties agreed that a base defence response fee was payable to JP Morgan in respect of that transaction.

The Court decided that JP Morgan was not entitled to a base defence response fee for each of the competitive offers that occurred in what it found was a single series of offers. It came to that decision based on the terms of the engagement letter as a whole and what it found to be the intentions of the parties. The concept was that in effect, the series of competitive bids was one process. Further, JP Morgan had already earned a base defence response fee from the first limb relating to the completed takeover.

The possibility of a series of competitive bids in a takeover battle is clearly foreseeable. If JP Morgan wanted a fee for the successful defence of each bid, its mandate should clearly have spelt that out.

"Plain English" or "commercial language" drafting is definitely not off the agenda for companies and their advisors but precision of drafting is and always has been crucial. Heavy duty legalese is rarely if ever required, but clear expression of the parties' intentions is always required. It can be a fine balance and very costly if not got right.