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Dentons DCM Quick Guide to Mandate Letters

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Key considerations for a debut issuer negotiating a Debt Capital Markets mandate letter

The first document encountered by a debut bond issuer when starting the process of preparing for their bond issue is likely to be the mandate letter (the ***Mandate Letter****). While a legally binding contract, the key purpose of the Mandate Letter is to assist the joint lead managers (the* ***JLMs****) and the issuer in documenting and managing their relationship.*

This note is written in the context of a "normal" European syndicated bond transaction where following announcement, marketing and bookbuilding, the JLMs and the issuer will know the final pricing and the underlying investor demand for the bond prior to entering into a subscription agreement. This is known as "soft" underwriting. If a transaction is underwritten prior to announcement and marketing (i.e. "hard" underwriting), further restrictions on the issuer (not discussed herein) are likely to be required in order to protect the JLMs and the prospects of a successful bond issue. The negotiation of the points set out below will also be further informed by the individual circumstances of the issuer and the transaction.

What is a Mandate Letter?

The Mandate Letter is an agreement between the JLMs and the proposed issuer appointing the managers in relation to the bond issue. Other parties who will be providing credit support to the bond issue may also be required to be parties to the Mandate Letter (e.g. significant guarantors) so that the JLMs know that there is substance behind the letter. As a private agreement, the Mandate Letter is expressly confidential, not intended to be made public and not shared with any other parties (although it may be reviewed by legal counsels to the JLMs and the issuer).

Who drafts and reviews the Mandate Letter?

The JLM who will be acting as "documentation bank" is usually tasked with drafting the Mandate Letter. It is normally drafted by the in-house legal team of that bank, based on an internal standard form and governed by the law that will govern the subscription agreement. As the first legal document prepared, the JLMs will aim to have it executed within a short period of time after the kick-off call on a bond transaction. While external legal counsel is often not involved in the negotiation of a Mandate Letter, a debut or infrequent issuer may wish to have their counsel provide comments on the first draft or to at least walk them through the legal consequences of signing the letter as drafted.

In starting to review a Mandate Letter, it is important for the issuer to consider the contractual relationship also from the perspective of the JLMs. In the bond issuance process, the JLMs are being asked to undertake significant amounts of work prior to the announcement of any potential transaction and so it is not surprising that they should wish to seek certain legal protections from the outset of the relationship.

What are the key commercial points and areas for negotiation?

Defining the transaction type

From the issuer's perspective, it is important that the Mandate Letter is clear on the type of transaction proposed. The Mandate Letter is not a commitment by the JLMs to underwrite, and equally is not a commitment by the issuer to issue, so any transaction size parameters should be expressed to be indicative only (e.g. a transaction of "up to" a certain size, or an "expected" size). As an issuer may have several simultaneous financing projects, the wording should be sufficiently clear so that there is no unintended overlap between the various appointments.

Confirming the exclusive appointment of the JLMs

The appointment of the JLMs will be exclusive (until the earlier of termination of the Mandate Letter or completion of the bond issue). If desired, the issuer may wish to reserve the right to add co-lead managers at a later stage (so that it can, for example, involve some of its lending banks in the issuance), and potentially the right to add a further limited number of additional JLMs. One important point to note is that it is standard for the appointment of the JLMs in the Mandate Letter to be on a several and not joint basis (regardless of whether the underwriting in the subscription agreement will be on a joint and several basis (Reg S) or a several and not joint basis (Reg S/144A)). In other words, the rights and obligations of each JLM under the Mandate Letter are separate and, if one JLM is unable to satisfy its obligations under the Mandate Letter, the responsibility to do so does not pass to the other JLMs.

No competing debt issuance

Known as the "clear market" provision, this clause is designed to maximise the potential for a successful bond issue, by ensuring that the issuer does not issue debt instruments that would form a competing supply for the transaction that is the subject of the Mandate Letter.

The clear market period usually begins on the date of the Mandate Letter and continues beyond the issue date of the bonds for a period usually between 30 and 90 calendar days depending on the type of issuer, the type of transaction and competing issuance flow. During this period, the issuer (and any guarantors) are often restricted from issuing or offering debt securities to the public or in a private placement in the international debt capital markets with a maturity greater than one year, without the prior written consent of the JLMs. The issuer may be able to resist the application of the clear market provision to domestic capital market issuance (where there is a mature, non-competing domestic bond market), to commercial paper issuance and, in some circumstances, to certain types of private placements. In addition, the clear market should only apply to entities that the issuer (or the guarantors) control (i.e. it should not apply to non-controlled affiliates).

The issuer and guarantors should consider carefully their potential funding requirements for the duration of the clear market clause and, if there are any potential conflicts, these should be discussed with the JLMs and any necessary carve-outs added to the Mandate Letter wording. Any similar provision in the subscription agreement for the transaction should be reviewed in light of the provision in the Mandate Letter to ensure that they do not conflict.

Rights to quote/match/first refusal

From January 2018, the UK FCA has banned managers from entering into agreements (including Mandate Letters), which gives them a right to provide future primary market and M&A services to their clients.[1] However, this ban does not prevent the JLMs from seeking rights to quote, rights to match and/or rights of first refusal in relation to non-primary market and M&A business, such as hedging. While including such "rights" in relation to hedging does not amount to an obligation on the issuer to conduct hedging, an issuer may wish to preserve flexibility, and if so should aim to water down any rights of first refusal to rights to match or ideally, to rights to quote. The issuer should also ensure that they are comfortable with the duration of such rights and the length of time they continue beyond the closing of the issuance (often three to six months, but sometimes a longer period).

Reimbursement of expenses

The JLMs will require full reimbursement of their out-of-pocket costs and expenses, regardless of whether or not the bond proceeds to closing. From an issuer's perspective, key points to consider are: (i) placing an aggregate cap on the expenses; (ii) requiring prior approval from the issuer before an individual expense over a certain threshold is incurred; and (iii) making the reimbursement of expenses payable on the earlier of either (a) closing of the bond issue, (b) the deal being significantly delayed or aborted, or (c) the Mandate Letter expiring or being terminated.

Fees

Fees customarily include a base fee component and a discretionary fee component, both expressed as a percentage of the principal amount of the bonds. The discretionary component is expressed to be payable at the absolute discretion of the issuer, without any set criteria. The provisions on fees will need to be clear as to what impact on fees the addition of any co-lead managers or additional JLMs (see "Confirming the exclusive appointment of the JLMs" above) will have – will such additional managers share from the already agreed fees, or will the overall fee amount increase to accommodate the new managers?

Limitation on liability and indemnity

It is customary for an indemnity in favour of the JLMs to be included in a Mandate Letter, covering any losses of the JLMs, their affiliates, and their respective directors, officers, employees, representatives and agents (the **Indemnified Persons**), where such loss is caused by, relates to, or arises out of the engagement. It is reasonably common for the indemnity: (i) to cover all losses but only those costs and expenses (including legal fees) which are "reasonably incurred"; and (ii) to be disapplied in respect of an Indemnified Person where the loss primarily arises due to the fraud, gross negligence or wilful default of the relevant Indemnified Person. JLMs will usually insist that any fraud, gross negligence or wilful default ought first to have been established by a court of competent jurisdiction before the indemnity is disapplied.

In relation to the potential liability of the JLMs to the issuer, it is customary that no Indemnified Person shall have any liability to the issuer or guarantors, or any other party, arising out of or in connection with the Mandate Letter and the services provided thereunder. This limitation on liability is also usually disapplied where the liability is finally determined by a court of competent jurisdiction to have primarily arisen from the fraud, gross negligence or wilful default of the relevant Indemnified Person (matching the carve out to the indemnity).

The Mandate Letter will also usually provide that no claims may be brought against any director, officer or employee of either (i) the JLMs and their affiliates, representatives or agents, or (ii) the issuer/guarantors and their representatives or agents. This is to prevent the threat of legal action against natural persons under the Mandate Letter.

1 The FCA ban applies to such services carried on from a firm's UK establishment or its overseas branches, and applies irrespective of the location of the client.

Announcements

The JLMs will wish to have some degree of control over announcements to be made by the issuer during the term of the Mandate Letter, as the issuer's announcements may impact the ability of the JLMs to market and sell the bonds. This is usually reflected in a clause that requires the issuer to consult with the JLMs in advance of announcements. Issuers should ensure that such requirement is limited to announcements in relation to (or perhaps which are relevant to) the engagement of the JLMs or that are related to the offering of the bonds. A carve-out should also be included to permit any announcements that are required by law or by any legal or regulatory authority or the rules of any stock exchange to which the issuer (or a guarantor, or its/their parent) are subject.

Termination and tail-fees

Each of the JLMs will have a right to terminate their appointment (in respect of themselves only) at any time prior to the signing of the subscription agreement. After signing of the subscription agreement, the JLMs may only terminate their involvement in the bond offering on the terms set out in the subscription agreement.

An issuer's right to terminate the Mandate Letter or the appointment of any particular JLM is often limited to the period of time prior to the launch of the bond offering (i.e. prior to the public announcement of the bond offering). This is because, from the time of launch, the JLMs are publicly linked with the bond offering and any termination of their appointment after this time would be public and so potentially a reputational concern for the JLM. If the issuer does not wish to proceed with the bond offering, the issuer can choose not to proceed to pricing and signing of the subscription agreement.

There is also often an automatic termination of a Mandate Letter after a certain period of time (i.e. an expiry clause), or upon either the signing of the subscription agreement or upon closing of the bond. Certain provisions (usually including the clear market, rights to quote/match/first refusal, tail-fee, expenses, confidentiality, indemnity provisions, announcements, conflicts of interest and governing law) will be expressed to survive termination or expiry. To avoid conflicting obligations, there should be a provision that, in the event of any inconsistency between the Mandate Letter and the subscription agreement, the terms of the subscription agreement shall prevail.

It is also typical that, regardless of who terminates the appointment of a JLM, this triggers the payment of that JLM's out-of-pocket expenses by the issuer. Issuers may, however, be able to negotiate in provisions to restrict or remove the payment of expenses to a JLM who has breached the terms of the Mandate Letter, failed to perform their obligations under the Mandate Letter or had their appointment terminated for fraud, gross negligence or wilful misconduct.

Finally, it is worth bearing in mind that, in the event that a Mandate Letter is terminated (or expires) without the bond being issued, it is customary for the JLMs to be entitled to a "tail-fee" (sometimes referred to as a "tail-gunner clause"). This tail-fee would be payable by the issuer if, within a certain period of termination or expiry (often six months), the issuer conducts a bond offering substantially similar to the bond covered by the Mandate Letter, with other JLMs. The priority of the issuer in negotiating this tail-fee clause should be seeking to: (i) ensure that a substantially similar transaction is defined as a bond offering to which the appointment in the Mandate Letter would have applied; (ii) exclude a JLM from being entitled to a tail-fee where the appointment has been terminated for "cause" (i.e. breach of the Mandate Letter, failure to perform obligations under the Mandate Letter, or fraud, gross negligence or wilful default); and (iii) exclude any JLMs from the tail-fee where the JLM has terminated the Mandate Letter (except where the JLM has terminated "with cause").

Please speak with any of the key contacts below if you would like to discuss bond issues and the negotiation of Mandate Letters for a bond issue in greater detail.

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