
Wisconsin Memorandum Ethics Opinion EM-19-02: Thrust upon conflicts in syndicated financing transactions

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Introduction and Preliminary Note on Terminology

This opinion addresses three scenarios that arise in the context of a syndicated loan, a fluid situation that presents unique and demanding conflict of interest issues. The examples discussed present situations that may not be regularly encountered, and as such, the State Bar’s Standing Committee on Professional Ethics (the “Committee”) believes that some discussion of terminology is appropriate

In general terms, “[s]yndicated lending is the extension of credit to a borrower by a defined group of lenders that are brought together by the lead bank or banks with the help, in many cases, of the borrower.” Reade H. Ryan, Jr., *The Role of Lead Counsel in Syndicated Lending Transactions*, 64 Bus. Law. 783, 783 n.1 (May, 2009). There is no particular set form of a syndicated transaction; such arrangements continue to evolve, and the precise roles of and relationship between the parties is determined on a transaction-by-transaction basis. See generally *id.* For purposes of this opinion, we assume that “syndicated financing” means some variant of a transaction in which a “lead arranger” (or “arranger”) assembles a group of lenders, each of which will participate fractionally in a larger loan facility in which each will assume a direct contractual relationship with the borrower, but whose essential terms almost always have already been negotiated between the borrower and an “administrative agent” (which is most often the same as or an affiliate of the lead arranger).

We distinguish a syndicated loan from a “participation loan,” in which a single lender or lender group loans money to a borrower and then sells an undivided interest in the loan and related collateral to “participant” lenders. Those participant lenders do not enter into a direct contractual relationship with the borrower and, accordingly, any adversity between a participant lender and the borrower would not be “direct” and, thus, not fall within the proscriptions of Rule 1.7.¹

¹ See, e.g., ABA Formal Op. 05-435, Ethical Obligations of a Lawyer Who Represents a Liability Insurer Named in the Litigation Who Simultaneously Represents a Client Against an Insured of the Liability Insurer (Dec. 8, 2004).

Discussion

- I. **Example A: Conflict arising solely out of borrower's counsel's simultaneous representation of a lender in unrelated, dissimilar matters**

I.

Example A: Big Bay Bank N.A. is the administrative agent and collateral agent in a large credit facility under which Bitcoin Harvester Inc. is the borrower. Bitcoin is represented in the financing by Rodgers & Associates, LLP. Although both Big Bay and Bitcoin anticipated that other financial institutions would ultimately make commitments under the credit agreement, their identities were unknown at the outset.

After months of work, Big Bay had received commitments from several other financial institutions to act as lenders under the credit agreement and continued to seek more as the date of closing approached. During this process, Big Bay counsel distributed the draft credit agreement to the committed lenders for review and comment and reached substantial agreement among them.

Two days before closing, L. Wahl & Sons Bank N.A., agreed to participate in the loan but sought to restrict Bitcoin's ability to incur other debt and to pledge its assets to a degree beyond the restrictions already negotiated between Big Bay and the other participating lenders. Upon learning of the issue, Rodgers (as noted, counsel to Bitcoin) realized that, although none of the attorneys working on the Bitcoin/Big Bay loan have ever provided services to Wahl, some of its other attorneys had represented (and continue to represent) it, albeit in other, unrelated transactions. Closing is scheduled for the next day, and Bitcoin needs Rodgers to advise it on the development.

As the example recognizes, in many if not most syndicated transactions the identity of the lenders may not be known to the borrower until closing is approaching. Assuming that the lender is represented by the borrower's law firm in other unrelated matters and is not utilizing the services of the law firm in connection with this particular syndication, the law firm cannot even arguably be said to have violated its duties to the lender unless and until its identity and interest in the syndication has been made known. There is no practical way that the law firm could search its database to detect a conflict before the identity of the lender is disclosed. Nor could the fact that the law firm unknowingly represents an aspiring lender in other matters have "materially limited" its representation of the borrower prior to that point. And it seems highly unlikely that the Firm could even inadvertently have used protected information of the (undisclosed) lender/client in representing the borrower since the identity of the lender/client is not known until shortly before closing.

Even when the identity of the lender surfaces, we are not convinced that a direct conflict has arisen with that lender. This is because, in the ordinary syndicated loan transaction, not only

does the borrower negotiate exclusively with the administrative agent, but the rights and obligations of the borrower have been largely finalized by the time the lenders identify themselves. Although the administrative agent may anticipate the collective needs and demands of the lenders that the lead arranger is attempting to assemble and take them into consideration when the administrative agent is negotiating with the borrower, we think that the number of potential lenders, their opacity to the borrower, and the role of the administrative agent all combine to allow the conflict to be characterized as indirect. Interested lenders ultimately will be presented by the administrative agent with a package that they may take or leave; any adversity with the borrower is at best indirect unless and until the lender seeks to interject itself directly into negotiations with the borrower, and the law firm may continue to represent the borrower without the lender's consent.²

At the same time, once the identity of the lender/client becomes known to the law firm, it could in theory cause the firm to advocate less vigorously in negotiating with the administrative agent (assuming there is anything left to negotiate). We believe this possibility is sufficiently remote that in most circumstances the firm representing the borrower will be able to conclude that the relationship will not adversely affect its representation of the borrower and the lawyer need not disclose the issue to the borrower/client and obtain its informed consent.³ It might also be prudent for the law firm to create an "ethical screen" between the attorneys working for the lender/client on other, unrelated matters and those working for the borrower on the syndicated loan, although this probably is superfluous if, as we have assumed, the different matters are unrelated.

If, however, we assume that the lender/client has interjected itself directly into negotiations with the borrower (and not through the administrative agent, as would be customary) despite the lateness of the hour and the presumptive control of the administrative agent, the law firm is faced with what is commonly referred to as a "thrust-upon" conflict.⁴ At this point, there are several options.

In an ideal world, the law firm would already have obtained a prospective waiver from the lender/client, either when it first established a relationship with the lender or when it realized

² Under these facts, the direct negotiations are with the administrative agent and the lender is making an economic decision as to whether to participate on those terms. See ABA Formal Opinion 05-434 "Direct adverseness requires a conflict as to the legal rights and duties of the clients, not merely conflicting economic interests."

³ See SCR 20:1.6(c)(6) with respect to disclosures necessary to detect and resolve conflicts.

⁴ New York City Bar Formal Opinion 2005-05 defined a "thrust-upon" conflict as follows: "For purposes of this opinion "thrust upon" conflicts are defined as conflicts between two clients that (1) did not exist at the time either representation commenced, but arose only during the ongoing representation of both clients, where (2) the conflict was not reasonably foreseeable at the outset of the representation, (3) the conflict arose through no fault of the lawyer, and (4) the conflict is of a type that is capable of being waived under DR 5-105(C), but one of the clients will not consent to the dual representation." A common example is when a currently represented corporate client acquires the opposing party in a matter.

that the lender was a frequent lender in syndicated transactions.⁵ Indeed, many large lending institutions incorporate prospective waivers into their “Guidelines for Outside Counsel” that allow their law firms to represent borrowers in transactions unrelated to matters on which the firm has represented the institution (although not all do). Nevertheless, it is not clear that this law firm should have anticipated the desirability of obtaining such waivers from its lending clients. Even if it did, it is not always possible to craft them with sufficient specificity to address this sort of situation, nor do all banking clients agree to prospective waivers.

In the absence of a prospective waiver, the firm should seek consent as soon as the lender interjects itself in the negotiations directly with the borrower. Contrary to the assumption contained in the hypothetical, we do not believe that the majority of lenders would refuse to grant such consent, either prospectively or contemporaneously. As noted above, many do so of their own initiative in their “Guidelines.” Moreover, it is not at all clear that an interested lender would have any incentive to force the borrower to obtain substitute counsel at the eleventh hour, particularly where, as here, the borrower’s law firm does not represent the lender in the transaction and does not possess any confidences from other, unrelated matters that would realistically present the prospect of unfair advantage. Nor is it clear that the administrative agent would tolerate such disruption by one lender if it threatened to derail the entire transaction.

We note that lending institutions often condition their waivers, whether prospective or contemporaneous, on a carve-out for “contentious disputes or litigation.” Although strictly speaking this constitutes a material limitation on the scope of representation which should be discussed with each client in obtaining the waiver, the limitation is perhaps less material than first meets the eye (and, for that reason, may require a less extensive discussion). Not only is such a carve-out common to the point of industry custom but, since there are often reasons why the deal attorneys should not be litigating disputes arising out of the deal, its practical effect may not be very great.

If, despite the foregoing, a waiver cannot be obtained from the lender (whether because of a conscious refusal or logistical obstacles), persuasive authorities agree that the law firm may cure the conflict by withdrawing from the representation of one client. New York City Bar Association Formal Opinion 2005-05 discussed this option as follows:

The commentary to the Model Rules supports this approach. As under the New York Code, the ABA Model Rules generally prohibit a lawyer from continuing to represent a client where that representation would be directly adverse to another client, or where a significant risk exists that the representation would be materially limited by the lawyer’s responsibilities to the other client. Model Rule 1.7(a). However, the commentary to Model Rule 1.7 suggests that in cases in which a conflict arises during the course of representation, and where the conflict was the result of “[u]nforeseeable developments, such as changes in corporate and other organizational affiliations,” the lawyer may have

⁵ See SCR 20:1.7, ABA cmt. [22]; ABA Formal Opinion 05-436.

the option to withdraw from one of the representations in order to avoid the conflict. Model Rule 1.7 Comment [5]. The District of Columbia ethics rules, which are based on the Model Rules, have taken this one step further and adopted an express "thrust upon" exception to the general prohibition against simultaneously representing two clients whose interests are directly adverse. DC Rule 1.7(d) provides that where certain concurrent conflicts are not reasonably foreseeable at the outset of representation, a lawyer should seek the opposing party's consent to the conflict, but if such consent is not given by the opposing party, the lawyer need not withdraw despite the opposing party's objection. See D.C. Eth. Op. 292 (1999) (interpreting Rule 1.7(d)).

The Restatement also supports a lawyer's ability to withdraw "in order to continue an adverse representation against a theretofore existing client when the matter giving rise to the conflict and requiring withdrawal comes about through initiative of the clients" so long as the situation causing the conflict was not "reasonably foreseeable" by the lawyer when the lawyer first undertook the representation of the client. Restatement (Third) of the Law Governing Lawyers § 132 cmt. j.

(footnote omitted)

Therefore the law firm should offer to withdraw from the representation of one client, which we believe in this case, for reasons discussed below, would be the lender, to cure the conflict.⁶ We recognize on these facts that the lender/client will likely object to the withdrawal or there will simply not be enough time to withdraw. In that case, we believe that the law firm may continue to represent the borrower through closing even without the lender/client's consent (although the informed consent of the borrower would, of course, be essential).⁷ We base this conclusion on a number of considerations.⁸

⁶ In considering from which client to withdraw, NYC Formal Op. 2005-05 advises the law firm "Where confidences will not be placed at risk, the overriding factor should be the prejudice the withdrawal or continued representation will cause the parties, including whether representation of one client over the other would give an unfair advantage to a client. The lawyer must also consider other factors, for example, the origin of the conflict (*i.e.*, which client's action caused the conflict to arise); whether one client has manipulated the conflict to try to force a lawyer off the matter and is using the conflict as leverage; the costs and inconvenience to the party being required to obtain new counsel, including the complexity of the representation; whether the choice would diminish the lawyer's vigor of representation toward the remaining client; and, the lawyer's overall relationship to each client."

⁷ DC Bar Ethics Op. 356 opined that where a lawyer could not seek consent to a thrust-upon conflict because of the duty of confidentiality, DC's unique version of Rule 1.7 permitted the lawyer to continue the conflicted representation without withdrawing or obtaining consent. Wisconsin's SCR 20:1.7 differs, but we point out that at least one jurisdiction recognizes that rare circumstances may justify a lawyer continuing an otherwise conflicted representation.

⁸ We also believe that these considerations warrant the law firm offering to withdraw from the representation of the lender rather than the borrower.

1. Rule of necessity: The duties set forth in the Rules of Professional Conduct are functional guidelines meant primarily to protect the interests of clients. Here, there is no solution that will fully protect the rights of both clients. If the law firm withdraws, the borrower's right to counsel of its choice will have been compromised; if the law firm does not withdraw, the lender/client's right to the undivided loyalty of its law firm will have been compromised. Put bluntly, one client's interests must be subordinated to the interests of the other. And that means the attorney's duty to one client must yield to its duty to the other client. The question is, "Which one?"

II.

2. Balance of prejudice: The situation presented by this hypothetical is somewhat analogous to that addressed by the "thrust upon" exception to the so-called "hot potato rule." In the most general terms, the "hot potato" rule prohibits a law firm from opportunistically terminating its representation of one client so that it can undertake a second (usually more lucrative) engagement for a client whose interests are adverse to the first client's. Without addressing the validity of the hot potato rule itself, many courts that would otherwise refuse to permit a law firm to continue representation in the face of a conflict will permit it to do so where the conflict was the result of events over which the law firm had no control (e.g., where a party adverse to a firm client was acquired by another firm client).⁹ One of the factors considered in determining whether, under the "thrust upon" exception, a law firm may continue to represent a client in the face of a conflict is the nature and degree of prejudice each client may suffer as a result. Under the hypothetical presented here, there is a significant imbalance in the type and degree of prejudice that would result to each client: If the law firm were forced to withdraw from representation of the borrower, the borrower would not only lose the counsel of its choice, but it could suffer significant economic harm consisting, at a minimum, of the cost of new counsel getting up to speed (including both additional attorneys' fees and transactional cost of delay); worse, a diminution of its negotiating leverage in the underlying transaction; and, worst of all, the collapse of the loan. The "benefit" to the second-tier participant from forcing borrower's counsel to withdraw, on the other hand, would be vindication of its abstract right to undivided loyalty in a matter in which it had not seen fit to engage the law firm.

On the other hand, if the law firm continues to represent the borrower, the prejudice to the borrower would be avoided. Although this would impinge the lender/client's right to the undivided loyalty of "its" law firm, it would have no necessary practical consequence in the other matters in which the firm represents the lender, since none of those other matters are related to the syndicated loan. Moreover, since, generally speaking, the duty of loyalty exists only during the attorney-client relationship, the lender/client could avoid the issue by discharging the law firm if abstract undivided loyalty is that important to it.

⁹ See e.g. *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F. Supp. 1121 (N.D. Ohio 1990); *University of Rochester v. G.D. Searle & Co.*, 2000 WL 1922271 (W.D.N.Y. 2000); *Carlyle Towers Condominium Association, Inc. v. Crossland Savings, FSB*, 944 F. Supp. 341 (D.N.J. 1996); *AmSouth Bank, N.A. v. Drummond Co.*, 589 So. 2d 715, 722 (Ala. 1991).

This imbalance of prejudice alone strongly suggests that the interests of the lender client must yield to the interests of the borrower client.

3. Relative ability of the parties to avoid the conflict: Although concepts of contributory fault are not usually relevant to ethical determinations, the different degrees to which the parties had any ability to avoid the dilemma here does seem relevant to determining on whom the burden of the dilemma must fall. Here,

a) A lender interested in a syndicated loan knows the identity of the borrower (and could determine the identity of the borrower's counsel if it was interested) before the borrower or its counsel know the identity of the lender; the lender is thus in a better position to identify possible conflicts and explore their possible resolution (or choose to avoid them altogether) earlier than the borrower or the law firm.

b) The lender, which is always free to pass up the opportunity if it is dissatisfied with the terms toward which the administrative agent is heading, creates the conflict by choosing to participate in the syndication in the first instance and exacerbates the issues by engaging in direct negotiations with the borrower rather than through the administrative agent, which is customary.

c) To the extent that the law firm's inability to obtain the consent of the lender is due to the latter's inexperience or bureaucratic impediments, that lender should be the one to suffer the consequences.

In sum, under the facts presented we believe that, with the informed consent of the borrower, the law firm could continue to represent the borrower in the transaction, even if it involved negotiation with the lender/client and even if that lender/client did not waive the conflict.

We caution, however, that our conclusion is highly fact-dependent, and limited to the specific facts given. A different conclusion might be reached where, for example, the conflict was not a "thrust-upon" conflict, time was not of the essence, the law firm was in possession of confidences of the lender/client that were relevant to the syndicated loan, or the influence of the lender/client presented a real risk of affecting the firm's ability to diligently and competently represent the borrower in the syndicated loan transaction. Finally, we note that there appears to be no Wisconsin case addressing a lawyer's responsibilities when faced with a thrust-upon conflict and exigent circumstances. While this opinion represents the best efforts of the Committee to determine the appropriate course of conduct, it does rely to a large extent on persuasive authority.

II. Example B: Conflict arising out of administrative agent's attorneys' simultaneous representation of one lender in unrelated but similar matters.

III.

Example B: The day before closing Bitcoin's credit facility, the agreement was in final form. Big Bay (as noted, the administrative agent and collateral agent) sought one more participant. It found one in Yellow Birch Financial. However, Yellow Birch sought to incorporate off-market flood insurance requirements, an unusual request. Big Bay sought advice from its own legal counsel, JT LLP. However, JT quickly realized that (a) one of its associates representing Big Bay

Bank in the present transaction had provided minor research assistance to Yellow Birch in connection with a bank regulatory compliance issue several months earlier, and (b) several other attorneys at JT have represented (and continue to represent) Yellow Birch in other syndicated financing transactions.

The hypothetical does not suggest any reason why an associate's minor research in a bank regulatory matter occurring several months before the transaction in question would, in and of itself, give rise to a conflict if the law firm were no longer representing the lender at the time of the syndication. The associate's work appears to be unrelated and highly unlikely to have resulted in the firm's possession of relevant information that could be used to the disadvantage of the lender in the syndication. Therefore, no former client conflict would arise under SCR 20:1.9(a).

On the other hand, the fact that other lawyers at the firm are currently representing the lender gives rise to a "direct adversity" conflict under SCR 20:1.7(a)(1), whatever the subject matter of their representation, since the negotiations would be directly between two clients. It could and probably does give rise to a "material limitation" conflict if the relationship with the lender was significant enough to color the advice given to the administrative/collateral agent. The fact that the firm is representing the lender in other syndications also suggests the possibility that the firm may possess relevant confidences although, since the terms of syndicated loans are largely driven by financial demands of the particular situation as negotiated between different borrowers and agents, this possibility does not seem great.

Like the law firm for the borrower, discussed above, the law firm for the administrative/collateral agent might have sought a prospective waiver from its lender/client beforehand and arguably was in a better position than the law firm for the borrower (which may never have entered into such a transaction before) to anticipate the need for one, particularly if it routinely represents syndicating-, administrative-, or collateral agents in syndicated loans.

Assuming no such foresight was exercised, the same dynamics relating to a request by a borrower's law firm for a contemporaneous waiver, discussed above, would seem to pertain. We think it is unlikely that the lender would refuse to grant a waiver, although it probably would condition it on the implementation of an effective screen and, as above, insist on a carve-out for "contentious disputes or litigation."

If the lender was unwilling to allow the law firm to represent the administrative/collateral agent in connection with the flood insurance issue, the law firm could explore the possibility that its client engage another firm for purposes of resolving the flood insurance issue.¹⁰ Consent of both the agent and the lender to this solution would be preferable. Again, we find it difficult to

¹⁰ Limiting the scope of a representation is recognized as a way to address conflicts. See e.g. New York City Bar Ethics Op. 2008-02; Restatement (Third) of the Law Governing Lawyers §121 cmt. c(iii) (2000).

imagine why the lender would not consent to such an arrangement given the economics of the situation.

The analysis in the first section applies to this situation. If the law firm cannot secure outside counsel to negotiate the flood insurance issue, the law firm would have to carefully consider whether its representation of Yellow Birch on other syndicated financings results in the possession of relevant confidential information and whether the participation of Yellow Birch was reasonably foreseeable. If the answer to both is no, and Yellow Birch refuses consent and withdrawal is not feasible, then, as discussed in the previous section, we believe the law firm may continue to represent Big Bay. The fact that this lender's appearance is so late and its demand so out of line with the position of other lenders tends to support this conclusion.

III. **Example C: Conflict arising out of concurrent representation of assignee**

IV.

Example C: Six months after closing, a competitor of Bitcoin, E-Currency LLC, acquired and assumed the fractional commitment of one of the other lenders under the revolving credit facility. E-Currency's sole reason for acquiring the commitment was to gain access to the financial projections and other non-public information Bitcoin is obligated to report to its lenders. Since neither prior notice nor consent to such assignment was required by the credit agreement, Bitcoin and its counsel were entirely unaware that E-Currency had become a lender until E-Currency opposed an amendment to the credit agreement that Bitcoin had requested. Bitcoin asks its counsel, Rodgers, for advice. It turns out that Rodgers is E-Currency's primary regulatory and government relations counsel, although no attorney working on the Bitcoin/Big Bay loan has personally represented E-Currency.

We begin our discussion of this example by noting that the facts presented appear unusual in at least two respects. First, in our experience, prior notice and consent is often a prerequisite for assignment; we do not think this conflict would often "sneak up" on the parties in the manner portrayed here. Second, although borrowers may seek to renegotiate or amend terms after the initial closing, they still usually do so through the administrative- or collateral agent, whose duties usually continue for the duration of the loan. Once again, the assumption of direct negotiations between lender and borrower is, we believe, exceptional.

Passing those observations, for the reasons discussed above, no ethical issue arises until the assignee surfaces because there is no means by which the law firm could discover the conflict or its actions be affected by it. Nor could the law firm be faulted for failing to request a prospective waiver from the assignee, since the circumstances of its acquisition of the loan seem highly unforeseeable.

Once the assignee surfaces, the situation is no different than the assignment of a simple mortgage loan. A direct conflict exists and must be analyzed under standard principles. As in the other examples, we once again see no reason in general why an assignee would be unwilling to waive the conflict, since the matters on which the law firm represents it are unrelated to the renegotiation of the loan. Moreover, and for the same reasons, in general the law firm might

choose to go forward without consent, since the “thrust upon” exception, which usually arises in mergers and acquisitions, is even more applicable here than in the first example.

Despite these general conclusions, the facts of this example include at least one factor which suggests the law firm may not want to ask for a waiver nor the client want to give one. The unusual (and arguably improper) motives behind this assignee’s acquisition could conceivably lead to a much broader and contentious dispute, which might not only taint the relationship with the assignee/client but arguably impair the law firm’s ability to represent the borrower/client.

Assuming that the firm is unable or unwilling either to request a waiver or rely on the “thrust upon” exception, it will have to withdraw from representing the borrower in connection with its negotiations with the assignee/client. However, we believe that the firm may continue to represent the borrower in finalizing negotiations with other lenders. Even though success with those other parties might in some way affect this assignee’s negotiating position, that effect would be indirect. Nevertheless, the firm would be well advised to screen the attorneys who represent the assignee/client in other matters.