COMMITTEE ON PROFESSIONAL ETHICS

Opinion 818 – 11/28/07

Topic: Conflicts of interest; persons paying for representation of another; designated underwriters' counsel.

Digest: Designated underwriters' counsel may represent the underwriters in a securities offering even though the issuer appointed and pays counsel, provided that underwriters consent after disclosure of material facts. In certain cases, with informed consent of the affected clients, designated underwriters' counsel may also represent the issuer.

Code: DR 5-101(A), 5-105(A), (B), (C), 5-107(A), (B).

QUESTION

1. When a law firm is selected by an issuer of securities to serve as the designated counsel for the underwriters of securities to be issued by that company or other entity, may the attorney also perform legal services for the company or entity?

OPINION

2. A common practice among issuers that frequently issue investment grade securities is to designate one law firm to represent the investment banks selected to underwrite the issuer's securities offerings (a "Designated Underwriters' Counsel"). This practice is common for both corporate and municipal issuers. Frequently, the issuer will make this designation even before it has determined to undertake an offering, decided on the type of offering, or selected who the underwriters will be.[1] And, often, the selected law firm will continue in that role for a considerable period, spanning multiple offerings.

3. The appointment of a Designated Underwriters' Counsel is thought to benefit the frequent issuer, underwriters and investors. Because such counsel works consistently on offerings of the issuer's securities, it becomes particularly familiar with the issuer,

---

[1] Letter from Bus. Law Section of the N.Y. State Bar Ass'n to the Sec. and Exch. Comm'n (Dec. 18, 2002), *available at* http://www.sec.gov/rules/proposed/s74502/gesbackman1.htm

and thereby better able to make judgments about the information that should be disclosed in offering documents. This familiarity may therefore improve the quality of disclosure in offering documents, lower transaction costs and promote the efficiency of the capital markets by allowing seasoned issuers to reach the capital markets quickly, as market and other opportunities arise. The ability to reach the capital markets quickly and opportunistically is particularly important in the context of so-called "shelf" offerings.[2] In addition, having a single law firm as underwriters' counsel for frequent issuers rather than different firms chosen by the lead underwriter for different offerings gives the issuer the benefit of underwriter's counsel more familiar with the issuer's business and able to update its knowledge more quickly and cost effectively.

4. Although – by definition – the Designated Underwriters' Counsel represents the underwriters, the counsel's fees are paid by the issuer. Further, as noted, the Designated Underwriters' Counsel is also selected for this work by the issuer. Occasionally, an issuer who becomes familiar with a law firm as underwriter's counsel may wish to hire the firm on an unrelated matter. An issuer may also wish to select, as Designated Underwriters' Counsel, a lawyer or law firm that regularly represents the issuer or that otherwise has a personal relationship with an officer of the issuer (e.g., a family member).

5. A law firm's work for the underwriters in an offering may conflict with the interests of the issuer. For example, there may be competing interests when negotiating the underwriting agreement – the contract pursuant to which the underwriting banks agree with the issuer to underwrite the securities to be sold. Similarly, in the course of preparing for a securities offering, there may be disagreement about what is "material" for purposes of disclosure in offering documents. As the Municipal Securities Rulemaking Board has explained, "The potential for conflict of interest is inherent in the issuer's selection of the counsel whose particular responsibilities may include advocating decisions that the issuer may oppose or may perceive as not to be in its best interest."[3] But while the underwriter and the issuer may be adverse to one another at certain points during the preparation of a securities offering, both have the shared goal of completing the offering in a timely manner and complying with all applicable laws.

ANALYSIS

6. Against this background, we examine the relevant ethical issues that Designated Underwriters' Counsel must keep in mind when representing the underwriters, both where such counsel performs no legal work for the issuer and where he or she does.

7. Where the law firm performs no work for the issuer. Lawyers are frequently engaged to represent a client where a third party will be responsible for payment of the lawyer's fees. One very common example is where an insurance policy protects the

---

[2] *Id.* Under SEC Rule 415, an issuer may file a registration statement in anticipation of selling securities at a later date. With its registration statement "on the shelf," the company is able to go to market quickly when conditions are favorable.

[3] MUNICIPAL SECURITIES RULEMAKING BOARD NOTICE, "Issuer Selection Of Underwriters' Counsel" (Sept. 3 1998), *available at* http://www.msrb.org/MSRB1/reports/0299v191/ucounsel.htm

client in connection with a litigated matter. As we said in N.Y. State 721, at 3 (1999), "Despite the fact that an insurance company has retained the lawyer pursuant to its contractual duty to defend the policyholder, the client is the policyholder, not the insurance company." The obligation to exercise independent professional judgment on behalf of the client continues even when the lawyer's fee is being paid by a third person.[4] The mere fact that a third party is paying the lawyer's fees thus does not present a disabling conflict.[5] Nor does the prospect of repeated work, for the same or different clients – be they policyholders or underwriters. Indeed, DR 5-107(A) and (B) specifically contemplates that third parties may be obligated to pay attorneys fees.

8. The Code explicitly requires that a lawyer whose fees will be paid by a third party obtain consent of the client, after full disclosure of all relevant facts and circumstances, before accepting such compensation. Investment banks in the business of underwriting are usually well aware of the role played by Designated Underwriters' Counsel and that their selection was made, and compensation will be provided, by the issuer. Accordingly, the underwriters' consent to the issuer's selection and payment of Designated Underwriters' Counsel is usually implicit in the underwriters' agreeing to serve as an underwriter in the contemplated transaction. But Designated Underwriters' Counsel specifically needs to consider, and fully disclose to the underwriters, any material facts or circumstances – beyond the selection as Designated Underwriters' Counsel by the issuer and what that ordinarily entails – that might bear on the lawyer's ability to exercise independent professional judgment on behalf of the client (the underwriter) or otherwise interfere with the lawyer's ability to adequately represent the client.[6] As an extreme example, such circumstances might include that a substantial percentage of the law firm's work consists of acting as Designated Underwriters' Counsel for the particular issuer whose securities the investment bank will be underwriting, or that the responsible partner is the brother of the issuer's chief financial officer or of the elected official responsible for the designation (in the case of municipal securities).

9. The Code also specifically cautions against the third party unduly interfering with the lawyer's representation of its client. Thus, the third party may not "impose

[4] *See*, *e.g.*, DR 5-107(B) ("Unless authorized by law, a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal service for another to direct or regulate his or her professional judgment in rendering such legal services, or to cause the lawyer to compromise the lawyer's duty to maintain the confidences and secrets of the client under DR 4-101(B).").

[5] *See* Nassau County 2003-2 (attorney may accept legal fees from a private school to represent students with disabilities and their parents in disputes with local school districts over the placement of students in appropriate schools even though in any given case the appropriate school may turn out to be a school other than the private school paying the attorney's fees).

[6] *See*, *e.g.*, DR 5-101(A) (absent informed consent, lawyer may not accept employment "if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests"); DR 5-105(A) (same if independent professional judgment will be or is likely to be adversely affected by other client relationships).

conditions that would lead to inadequate representation or constrain the lawyer's independent professional judgment on behalf of the client."[7]

10. Where the law firm performs work for the issuer. Outside counsel to an organization or municipality obviously owes duties to the client, including the duties of zealous representation and loyalty. Where a law firm that represents an issuer is selected to serve as Designated Underwriters' Counsel, there is a potential for conflict.

11. The Code defines "differing interest" to mean "every interest of a client that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest." Because the interests of an issuer and its underwriters may differ during the course of an offering (e.g., on what disclosures are necessary), it is possible that a law firm that currently represents both the underwriters and the issuer will be subject to "differing interests" that would preclude accepting the assignment as Designated Underwriters' Counsel or require withdrawing from it.[8]

12. In certain circumstances, however, conflicts can be waived by the clients: a lawyer can represent multiple clients with differing interests if a disinterested lawyer would believe that the lawyer can competently represent the interest of each client, and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.[9] That analysis is fact intensive.[10] For example, if all or substantially all of the lawyer's income was derived from representing the issuer, a disinterested lawyer would likely conclude that the lawyer could not competently represent the interests of the underwriters in connection with an offering.[11] Another example would be if a law firm were asked to represent both the issuer and the underwriters in connection with the offering itself. This is ethically permissible in certain situations, but before undertaking the representation the firm would need to obtain informed consent from each client, and to take precautions in the event that disputes among the clients arose (such as having other counsel, for example, in-house counsel, handle those aspects of the matters).[12]

---

[7] N.Y. State 721, at 4 (1999) (attorney may ethically adhere to an insurance company's numerous guidelines regarding legal research, provided that the attorney remains able to provide competent representation to his or her client).

[8] DR 5-105(A), (B).

[9] DR 5-101(A); DR 5-105(C).

[10] *See* Iowa Opinion 2006-03 (law firm may, with consent, represent issuer in a bond offering where it has represented, or does represent, the underwriter in unrelated matters); N.Y. City 2001-2 (under certain circumstances, law firm may represent multiple clients on different sides of the same transaction).

[11] This example is meant only for illustrative purposes and not to define an outer boundary. Specific facts and circumstances will dictate when the relationship between the lawyer, or law firm, and the issuer is such that the disinterested lawyer test would not be met.

[12] *See* N.Y. City 2001-2; N.Y. State 807 ¶ 11 (2007) ("a single lawyer may, in unusual and very limited circumstances, undertake dual representation of both parties to a real estate transaction"). On the other hand, where accommodations can not be made, joint representation may not be possible. *See* N.Y. State 753 (2002) (lawyer may not generally represent both the buyer and the lender in a real estate transaction).

13. Where consent is available, the lawyer or law firm should, in framing the appropriate disclosure, consider the amount of work done for the issuer, the importance of that work to the law firm (financially or otherwise), and any other connections between the law firm and the issuer. For example, litigators at the law firm acting as the Designated Underwriters' Counsel may be representing the issuer in a lawsuit that will be the subject of due diligence (and, possibly, the subject of disclosure in the offering documents). In considering whether to seek consent of the issuer and underwriter in this situation, consideration should be given to whether the litigators may be called upon to reveal information to the corporate lawyers performing due diligence, and if so on what terms. The lawyer may wish to consider whether it is appropriate to advise the issuer to waive confidentiality vis-à-vis the underwriters and the effect on the privilege of doing so, or instead, for example, to set up firewalls to "screen" off the two sets of lawyers. All of this will require the informed consent of the clients, which consent will be effective only if the disinterested-lawyer test of DR 5-105 is met.

CONCLUSION

14. A law firm selected to serve as Designated Underwriters' Counsel by a company must carefully consider its relationship with the company selecting it, and assess whether a disinterested lawyer would conclude that the law firm can competently represent the interests of the underwriters in light of its relationship with the company, and if so, ensure that the underwriters appropriately consent to its representation of them.