Lend Me Your Counsel

Law Working Paper N° 890/2026
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We thank workshop participants at the Law and Finance of Private Equity and Venture Capital conference at the London School of Economics, Conference on Empirical Legal Studies at Georgetown University, Cornell University, Duke University, and Washington University in St. Louis, as well as Kenneth Abraham, Adam Badawi, Lucian Bebchuk, Abraham Cable, Trevor Clark, Elisabeth de Fontenay, Nora Engstrom, Matteo Gatti, James Grimmelmann, Suren Gomtsian, Mitu Gulati, Chris Hale, Valerie Hans, Michael Heise, David Hoffman, Howell Jackson, Matthew Jennejohn, June Kim, Reinier Kraakman, Narine Lalafaryan, John Morley, Michael Ohlrogge, Elizabeth Pollman, Adriana Robertson, Stewart Schwab, Joel Seligman, Per Strömberg, Eric Talley, Tobias Tröger, Anne Tucker, Kristen Underhill, and Simon Witney. We are grateful to Shunkai Ding for excellent research assistance and to our interview participants for sharing their insights.

Abstract

This article examines the practice of borrower-designated lenders' counsel: a quirky transactional practice that helps fuel $1.7 trillion in deal volume every year. Private equity firms borrow money to finance mergers and acquisitions (M&A) transactions—but interestingly, they choose their lenders' lawyers and pay the lenders' legal bills, too. This widespread practice of borrower-designated lenders' counsel, also called "designation," is widespread in leveraged lending. This article shines a light on designation. It brings into the scholarly discourse practitioners' publications and original interviews, illuminating the nuances of the practice, explaining the complex set of incentives and norms that have fueled it, and considering the many questions and avenues for new research that designation brings to the fore. This article makes three contributions. First, drawing on practitioners' literature and original interviews, we introduce a robust and nuanced description of the practice of designation. This practice occurs in the law's peripheral vision, in the secondary borrowing transaction that supports many major M&A transactions. And while its impact on M&A may be profound, designation is deeply under-explored in the academic literature. Second, we explain why this practice arose and became dominant. Using interviews with both borrower- and lender-side counsel, we show how an intricate web of norms, law firm billing practices, lenders' financial incentives, and even lenders' rankings contribute to the practice of borrower-designated lenders' counsel. We also discuss how law firms have made peace with the process via their own set of industry-wide norms that are meant to mitigate conflicts and divided loyalties. Finally, we discuss the implications of this practice for theory and practice, including transactional efficiency and attorney ethics.

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LEND ME YOUR COUNSEL

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This article makes three contributions. First, drawing on practitioners' literature and original interviews, we introduce a robust and nuanced description of the practice of designation. This practice occurs in the law's peripheral vision, in the secondary borrowing transaction that supports many major M&A transactions. And while its impact on M&A may be profound, designation is deeply under-explored in the academic literature. Second, we explain why this practice arose and became dominant. Using interviews with both borrower- and lender-side counsel, we show how an intricate web of norms, law firm billing practices, lenders' financial incentives, and even lenders' rankings contribute to the practice of borrower-designated lenders' counsel. We also discuss how law firms have made peace with the process via their own set of industry-wide norms that are meant to mitigate conflicts and divided loyalties. Finally, we discuss the implications of this practice for theory and practice, including transactional efficiency and attorney ethics.

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INTRODUCTION

The phenomenon of *borrower-designated lenders' counsel*, also called "designation," is a widespread practice in which borrowers choose—and pay for—their lenders' counsel. And although this process originated in London,[1] it has become commonplace in the United States, where it greases the wheels of a $1.7 trillion annual private equity mergers and acquisitions (M&A) industry.[2]

Even at first blush, designation raises numerous questions. There are clear attorney ethics issues: Can lawyers chosen and paid for by borrowers be zealous, loyal counselors to their lender clients?

But designation raises deeper questions, too.

Designation provokes theoretical questions relating to contract design and interpretation—how carefully are debt contracts being designed, and does that matter for how courts should interpret them? And, because loan terms have implications for repayment, the practice raises worries about financial stability and systemic risk. This article brings a nuanced and layered account of this practice into the fore and explores the theoretical and practical questions that flow from it.

To understand the scope of the issue, one must understand the nature of private equity M&A. Nearly all of the money that fuels private equity is borrowed from banks and other lenders,[3] making private equity M&A transaction two transactions in one.

At the core is the M&A transaction: a company is up for auction and bidders, including private equity firms, usually called sponsors, try to win the auction. But private equity bidders depend on borrowed money,[4] so at the same time that the private equity bidder is preparing a bid in the core M&A transaction, they are also negotiating an ancillary borrowing transaction. It is during that borrowing transaction that designation occurs.

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[1] Lawyer #18. As to the interviews conducted, see Appendix A. *See also* Trevor Clark, *The Pendulum Swing in Leveraged Finance Loan Terms: The Role of Designation*, 38(2) J. INT'L. BANK. L. & REG. 45, 46 (2023) [hereinafter, Clark, *The Pendulum Swing*].

[2] Andrew J. Nussbaum, Steven A. Cohen & Igor Kirman, *Private Equity—2024 Review and 2025 Outlook,* HARV. L. SCH. F. CORP. GOV. (Jan. 24, 2024), https://corpgov.law.harvard.edu/2025/01/24/private-equity-2024-review-and-2025-outlook/; Leslie M. Smith, *Private Equity's Growing Role in M&A Has Clear Benefits*, DENTONS (Aug. 7, 2023), https://www.dentons.com/en/insights/articles/2023/august/7/private-equitys-growing-role-in-m-and-a-has-clear-benefits.

[3] Rosemary Batt & Eileen Appelbaum, *The Agency Costs of Private Equity: Why Do Limited Partners Still Invest?*, 35 ACAD. MGMT. PERSPS. 45 (2021) (noting that banks and other creditors offer substantial loans for private equity deals).

[4] *Id.*

During this borrowing transaction, lenders who want to have a chance to lend money to bidders for the M&A deal participate in a financing auction or "bake-off": a competitive process after which the bidder chooses their preferred lender (or set of lenders).[5] Because the bake-off process is so competitive, lenders have little choice but to participate in the bake-off on the sponsor's terms—including, surprisingly, accepting the counsel that the sponsor has chosen to represent all the lenders.[6]

This borrower-designated lenders' counsel is almost always a large law firm. All those regularly mentioned by our interviewees are in the highest echelons of law practice.[7] This borrower-designated lenders' counsel represents the lenders competing in the bake-off, negotiating potential loan terms with the sponsor, and it will continue to represent the winning lender to document the loan if the sponsor's M&A bid succeeds.[8] In other words, the private equity borrower selects the counsel for the lenders across the bargaining table and pays the legal bills. Importantly, once the banks lend the money, they generally sell off the debt to nonbank institutional investors such as collateralized loan obligations, loan mutual funds, and insurance companies.[9] Accordingly, the loan terms that their counsel negotiate are often passed on to investors. Banks may retain some loans, too, exposing them to the potentially less-than-ideal deal

[5] "Bake-offs" are auctions where multiple parties compete for the same deal. Many practitioners, both in written materials and in interviews, referred to financing auctions as bake-offs. There are also bake-offs in the M&A context, where multiple potential service providers may choose their advisors. *See* Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing,* 2; and Darshil Shah, *8 Key Steps in a Typical Sell-Side Merger Process*, FORBES (Aug. 9, 2023), https://www.forbes.com/councils/forbesfinancecouncil/2023/08/09/8-key-steps-in-a-typical-sell-side-merger-process/.

[6] *See* Part II, *infra*.

[7] To protect interviewees' anonymity, we agreed not to use interviewee names or firm names in this article. Because of how many lawyers are needed to work on a bake-off process, only a small handful of elite firms, ranked toward the top of Vault 100 law firm rankings, have the staffing to accept designations.

[8] *See* Part II, *infra*.

[9] *See* Cathy Hwang, Yaron Nili & Jeremy McClane, *The Lost Promise of Private Ordering*, 109 CORNELL L. REV. 1, 32-41 (2024); Frederick Tung, *Do Lenders Still Monitor? Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 153, 157 (2021).

terms generated by a suboptimal process.[10] The risks raised by these loans have troubled federal banking regulators.[11]

Lawyers are their clients' trusted advisors and advocates, so the idea that one's lawyer might be selected and paid for by one's bargaining counterparty is rather shocking. Reporting in 2023, *Law.com* called designation "the most problematic issue in corporate law."[12] These concerns echoed those of a *New York Times* Dealbook column, in which Andrew Ross Sorkin called the practice "conflict-ridden" and "insidious."[13] Debt market publication *Private Debt Investor*

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[10] The ultimate fear of such conflict and potential poor process, of course, is that one party ends up with an unfair deal. These outcomes have been documented in conflicted venture-capital sales transactions as well as in conflicted debt transactions. *See* Bo Bian, Yingxiang Li & Casimiro A. Nigro, *Conflicting Fiduciary Duties and Fire Sales of VC-Backed Start-ups*, LAWFIN WORKING PAPER No. 36 (2022) (finding that in certain VC-backed transactions with liquidity pressure, sale prices are lower and there is a positive abnormal return for acquirers. Based on these findings and others, the authors argue that these "fire sales" can harm common stockholders and create conflicts for the VC-appointed board members of the company being sold); and Yijia (Eddie) Zhao, Ruiyuan (Ryan) Chen, Douglas J. Cumming, and Binru Zhao, Private Equity Sponsors, Law Firm Relationship, and Loan Contracts in Leveraged Buyouts, ECGI Working Paper No. 1013/2024 (Dec. 2024 draft), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4956448 (finding that pre-existing relationships between sponsors and lenders' counsel have a negative effect on the strength of loan terms). Another fear is that poor process allows parties to engage in suboptimal rent-seeking. *See* Tobias H. Tröger, *Corporate Groups*, SAFE WORKING PAPER No. 66 (2014) (discussing the challenges of regulating rent-seeking among corporate groups, including those that become majority shareholders).

[11] In 2013, the Office of the Comptroller of the Currency, Department of the Treasury; Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation provided guidance to banks highlighting risks from leveraged lending. *See* DEPT. OF THE TREASURY, OFFICE OF THE COMPTROLLER OF THE CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS. & THE FED. DEPOSIT INS. CORP., INTERAGENCY GUIDANCE ON LEVERAGED LENDING ACTIVITIES (2013), http://www.fdic.gov/news/news/press/2013/FR-LL-Preamble-and-Guidance.pdf. On December 5, 2025, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation rescinded this 2013 guidance. *See* https://www.occ.treas.gov/news-issuances/news-releases/2025/nr-ia-2025-119.html. The importance of regulating private equity for the purpose of financial stability has also been discussed across the pond. *See, e.g.,* Sally Gibson & Simon Witney, *Policy, Regulation & Private Equity: A Rich Research Agenda?*, ROUTLEDGE COMPANION TO MGMT. BUYOUTS (2017) (discussing the then-new Alternative Investment Fund Managers Directive, an EU private equity and venture capital fund regulation, which considered such aims to ensuring that fund employees' payment does not cause conflicted decision-making and promoting financial stability).

[12] Jack Womack, *Why 'Designated Counsel' is the Most Problematic Issue in Corporate Law,"* LAW.COM (Feb. 28, 2023), https://www.law.com/international-edition/2023/02/28/why-designated-counsel-is-the-most-problematic-issue-in-corporate-law/.

[13] Andrew Ross Sorkin, *A Growing Conflict in Wall Street Buyouts*, N.Y. TIMES (Jan. 4, 2016), https://www.nytimes.com/2016/01/05/business/dealbook/a-growing-conflict-in-wall-st-buyouts.html. Designation is under investigation by the International Organization of Securities Commissions, the umbrella body internationally for securities regulators, which notes that designation gives rise to conflicts of interest "whereby lawyers representing the banks might be reluctant to push back against sponsor lawyers due to the risk they could be excluded from the

also recently raised concerns, noting that the "[t]he biggest risk . . . in these situations is that [lenders'] lawyers go soft on terms and fail to fully explore how soft they are . . . [And] this may not be apparent until it is too late, . . . and the [lender] finds it does not have the rights it thought it should."[14]

The existence of designation in a transaction ancillary to M&A is also particularly puzzling. Process has always been foundational to U.S. corporate law,[15] and especially to M&A. Companies can use good process to cleanse conflicted transactions that would otherwise be subject to stricter judicial review, for example.[16] And every corporate law student in the country learns that the board's poor process in the 1980s sale of TransUnion led to the establishment of a cottage industry around corporate valuation and fairness opinions—now an essential part of the M&A sale process.[17] But how robust can an M&A process be when a critical piece of it—the necessary financing—involves a negotiation in which the lenders' lawyers may answer to the borrower?

In recent years, banking regulators reportedly investigated the practice of designation, although the results of these investigations do not appear to have been publicly disclosed.[18] The New York Bar—most of these transactions are

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market for lender-side work." THE BOARD OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, LEVERAGED LOANS AND CLOS: GOOD PRACTICES FOR CONSIDERATION CONSULTATION REPORT 34-35 (2023).

[14] John Bakie, *Designated Lenders Could Leave Lenders in the Lurch*, PRIV. DEBT INVESTOR (Jul. 1, 2019), https://www.privatedebtinvestor.com/sponsors-designated-lawyers-weaken-protection-debt-funds/.

[15] *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021) (discussing how various processes and norms within American corporate law operate to orient corporate law toward shareholders); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (finding that a board of directors that did not engage in sufficient process during a sell-side M&A transaction would not be afforded business judgement rule deference by courts when the court later evaluated the board's decisionmaking).

[16] Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939, 951-58 (2019) (describing cleansing devices and standards of review). *See also* Corwin v. KKR Financial Holdings, LLC, 125 A.3d 304 (2015) (holding that transaction that would otherwise be subject to entire fairness review could instead be subject to business judgement review if the transaction was approved by a fully informed, uncoerced vote of the disinterested stockholders).

[17] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). *See also* Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1453 (1985) (noting that after *Smith v. Van Gorkom*, "no firm considering a fundamental corporate change will do so without obtaining a fairness letter").

[18] Jason M. Halper & Rob McKenna, *Designated Lender Counsel in Private Equity Loans*, HARV. L. SCH. F. CORP. GOV. (Jan. 19, 2016), https://corpgov.law.harvard.edu/2016/01/19/designated-lender-counsel-in-private-equity-loans/ (suggesting that if designated lenders' counsel adversely affected lenders that lead arrangers "should expect inquiries from any number of potential government authorities, including the Federal Reserve, the Office of the Comptroller of the Currency (the "OCC"), the Federal Deposit Insurance Corporation (the "FDIC") and state authorities such as attorneys general and financial supervisory agencies.").

being done by New York law firms and lawyers—has also looked into designation, although its guidance was offered on highly stylized facts.[19] And although this troubling practice lies just below the surface of a $1.7-trillion industry, it is under-studied and little understood in the academic literature.[20]

To better understand designation, we turn first to practitioners' literature—literature created by lawyers for other lawyers, largely for training and/or marketing purposes—to develop a robust description of this practice. We show the intricacies of how designation works, and how the lawyers and parties, in theory, navigate the complex web of potentially divided loyalties.

In addition to this novel descriptive account, we also use original interviews with practitioners—both those who primarily represent lenders and those who primarily represent sponsors—to understand *why* designation works the way it does. Our interviewees overwhelmingly reported that borrower-designated lenders' counsel is an efficient practice—and, given the short timeframe in which these deals are completed, a necessary one.[21] But our conversations also uncovered a complex web of norms and incentives that encourages the parties to accept the practice, even as lenders have been known to express frustration and even as some lender-side lawyers admit that they feel pressure to serve the interests of sponsors, who are not their clients.[22] Factors such as contingent payment for lenders and their counsel, relationships between sponsors and lawyers, and even how banks gain accolades for lending in M&A transactions contribute to the persistence of borrower-designated lenders' counsel.[23]

Industry insiders claim that it is possible for counsel, who are *chosen and paid* by a party across the bargaining table from their client, to vindicate their client's interests adequately. They justify their confidence by recourse to repeat playerism.[24] Specifically, they claim that no decent lenders' counsel would short-change their own client because that counsel's reputation would suffer,

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[19] *See infra* Part IV.A.

[20] The only study we know of that purports to investigate the impact of designation on loans is Yijia (Eddie) Zhao, Ruiyuan (Ryan) Chen, Douglas J. Cumming, and Binru Zhao, *supra* note 10. The study investigates the impact of pre-existing relationships between sponsors and lenders' counsel on the strength of loan terms, finding that when a private equity sponsor has a strong relationship with the lenders' counsel, the resulting loan documents will be more sponsor-friendly. However, the study does not appear to distinguish between loans that involve designated lenders' counsel and non-designated lenders counsel—which is unavoidable, as the fact of designation is not generally disclosed. Regarding UK deal practices, authoritative contributions have been made by Trevor Clark. *See* Clark, *The Pendulum Swing*, *supra* note 1; Trevor Clark, *Transaction Costs and Big Law* (2024), https://ssrn.com/abstract=5140873.

[21] *See* Part III.A, *infra*.

[22] *See* Part III, *infra*..

[23] *Id.*

[24] *Id.*

influencing their ability to obtain future work. The thinking here is that sponsors have incentive to keep potential lenders happy and willing to lend in the future—a willingness that will dissipate if lenders believe that sponsor-designated lawyers are not representing them effectively. Therefore, lender-side lawyers are in turn incentivized to do right on behalf of their clients, demonstrating their loyalty and professionalism. In other words, repeat playerism sufficiently curbs any potential ethical issues.

But a closer look beneath the hood reveals a more complex story. Many of the lenders' counsel interviewed reported that they hoped to be "user-friendly" to the borrower, even as they represented the lender—in other words, in the course of negotiations, these lender-side lawyers present their clients' preferences in ways designed to satisfy the borrower.[25] Interviewees also reported that lenders sometimes hired "shadow counsel"—their own wholly independent counsel, unsullied by connections or money to the borrower—to provide legal advice. Why hire shadow counsel if the designated counsel is believed to be doing a good job?

Our article is a first foray into the world of borrower-designated lenders' counsel in the United States. In doing so, it contributes to the corporate law literature—as well as literatures in ethics, transactional lawyering, private equity, and corporate contracts—a nuanced account of this widespread practice that underlies and drives significant deal volume every year. The remainder of this article proceeds in four Parts. Part I provides a brief overview of the leveraged M&A process. It is within this transaction process that designation thrives. As bidders secure financing to make their bids for a target company, they choose lenders from which to borrow money—and choose those lenders' lawyers, too. In Parts II and III, we dive into uncharted waters. Relying on practitioners' literature and interviews, we bring to the legal academic literature a detailed description of designation. Then, using original interviews with practicing lawyers, we explore why designation thrives in private equity. We show that a complex web of factors—timing, norms, and even lenders' industry rankings—contributes to the practice's chokehold on the industry. Finally, in Part IV, we examine theoretical and practical implications. Designation's impacts are wide-ranging and virtually unexplored. We consider the implications of this practice for many areas of future research and policymaking, including ethical lawyering, financial stability, contract interpretation and more.

I. LEVERAGED BUYOUTS AND PRIVATE EQUITY: A BRIEF OVERVIEW

The heart of this article is an exploration of a little-understood practice—borrower-designated lenders' counsel. In Parts II and III, we detail that practice and show how a complex set of norms within the private equity and debt industries contributes to this widespread practice. This Part sets the

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[25] *Id.*

stage by explaining how M&A auctions, leveraged buyouts (LBOs), and related lending transactions intersect.

A. M&A Auctions and Leveraged Buyouts

Companies looking to sell themselves often do so through an M&A auction: a process by which prospective bidders have an opportunity to do due diligence on the target company and submit bids to purchase the company.[26] This is a competitive and often multi-stage process, in which many aspects of a bidder's offer inform the target's decisionmaking. Important aspects include the bidder's proposed price, the likelihood of obtaining regulatory approvals, the bidder's likelihood of being able to pay for the deal, the identity of the bidder, and the proposed timing of the deal.[27] Broadly speaking, the target wants to be as certain as possible that the bidder will be able to close the deal, given the terms and any other factors weighing on the transaction.[28]

Financing is a particularly important part of these bids, and especially so for M&A bids arising from private equity firms, also known as sponsors. Because of their business model—which we discuss in more detail in the next subpart—sponsors bidding in M&A auctions tend to borrow most of the money used to finance deals. As a component of their bids, sponsors disclose their borrowing plans and outline contingencies if those plans fall through.[29]

In LBO bids,[30] sponsors often borrow 60-70 percent of the purchase price,[31] making the availability of funds central to the deal certainty that target

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[26] WACHTELL, LIPTON, ROSEN & KATZ, TAKEOVER LAW AND PRACTICE 60-61 (2025). Target companies often use auctions since their boards often owe *Revlon* duties, requiring them to maximize sale price. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). As to *Revlon* duties in the context of leveraged buyouts, see In re The Topps Co. S'holders Litig., 926 A.2d 58, 64 (2007); In re Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007).

[27] WACHTELL, LIPTON, ROSEN & KATZ, *supra* note 26, at 60-61.

[28] *Id.*

[29] *Id.* at 127-28 (describing the types of financing conditions that might be submitted with an M&A bid and their effect on deal certainty).

[30] A leveraged buyout, or LBO, is any M&A transaction that relies heavily on debt. Most often, however, the term refers to a specific type of debt-financed transaction, where the buyer, usually a sponsor, secures its debt using assets from the target company that it purchases. Aswath Damodaran, *The Anatomy of an LBO: Leverage, Control & Value* (working paper), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1162862. As to the general characteristics of debt, private and public, see Suren Gomtsyan, *Debtholder Stewardship*, 86 MOD. L. REV. 395 (2022).

[31] *See* JOSHUA ROSENBAUM & JOSHUA PEARL, INVESTMENT BANKING: VALUATION, LEVERAGED BUYOUTS, AND MERGERS & ACQUISITIONS 199 (3d ed, 2022). A small portion of the equity contribution may also come from the target company's managers. *Id.* As to the structure, see Andrew F. Tuch, *Managing Management Buyouts: A US-UK Comparative Analysis,* in RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE (A. AFSHARIPOUR & M. GELTER EDS., 2021) [Hereinafter, Tuch, *Managing Management Buyouts*].

companies are looking for.[32] To demonstrate financial viability, bidders who plan to use debt will submit debt commitment letters with their bids for the target company. These letters typically include a term sheet,[33] which attests that lenders have committed to lend specified funds on specified terms.[34] In this way, a bidder shows a target company that they have access to the funds necessary to complete the transaction if their bid succeeds.

In order to find lenders willing to provide the commitment papers—and, ultimately, financing—sponsor bidders will often conduct a "bake-off." A bake-off is itself an auction, in which potential lenders compete to lead the deal to fund the LBO. Potentially, many lenders will eventually provide financing, but the winner of the bake-off becomes the lead lender—or "lead left," based on the location in which they are listed on lending documents. The lead left commits to lend the most and stand to reap the greatest profits among the lenders.[35] Other lenders participating in the bake-off may commit to funding a smaller percentage of the required funds.

B. Private Equity and Debt

Sponsors are in the business of buying companies, which they renovate for later sale.[36] They generally buy public companies and take them private. To accomplish this, they use money contributed by investors (on whose behalf they invest), as well as significant amounts of debt.[37] These borrowed funds both amplify returns and discipline management by restricting discretionary cash flow. As Michael Jensen theorized, debt forces managers to generate returns to meet interest and principal payments, curbing opportunism and shirking.[38]

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32 *Id.*

33 Practical Law Finance, Commitment Letters Overview: Lenders – Timing and Process (Westlaw) ("A commitment letter has a term sheet attached as an exhibit which sets out the general terms of the financing.").

34 Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing*, 3 (2024); Practical Law Finance, Commitment Letters Overview: Lending, Westlaw (defining a commitment letter). These terms are highly negotiated and complex. *See* Adam Badawi, Scott D. Dyreng, Elisabeth de Fontenay & Robert W. Hills, *Contractual Complexity in Debt Agreements: The Case of EBITDA* (draft), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455497.

35 For a detailed discussion of leveraged loans (the class of loans that includes those supporting LBOs) and the role of the "lead left," or arranger, see Vincent S.J. Buccola & David A. Hoffman, *Precedent Terms*, (May 21, 2025), University of Chicago Law School, Coase-Sandor Institute for Law & Economics Research Paper No. 25 - 20, U of Penn, Inst for Law & Econ Research Paper No. 25-09, https://ssrn.com/abstract=5263762.

36 *See* Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, J. ECON. PERSPS., Winter 2009, at 121.

37 *Id.*

38 Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 323-26 (1986). See also id. at 326 ("Success requires (among other things) implementation of changes to avoid investment in low return projects to generate the cash for debt service and to increase the value of equity.").

Private equity has proved enormously attractive to investors, reshaping M&A activity and capital markets. Since emerging as a business transaction in the 1980s,[39] LBOs have grown to account for roughly 40 percent of annual M&A value.[40] Sponsors manage trillions of dollars' worth of companies acquired through LBOs,[41] contributing to what scholars regard as the decline of public companies and markets.[42]

The private equity business model has also transformed lending.[43] Through credit funds, sponsors now also lend to other sponsors who are engaged in LBOs.[44] Sponsor-backed lending—often called direct lending or private credit—competes directly with banks in LBO financing.[45]

The lending bake-off, in which multiple potential lenders duke it out for the opportunity to lend to a bidder, occurs right at the intersection of M&A auctions, LBOs, and lending. Sponsors and lenders are the key bake-off participants, but lawyers also play a critical role. Since sponsors often bring in the same cast of actors deal after deal, bake-offs involve repeated interactions

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39 *See* Steven N. Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217, 217 (1989) (describing private equity buyouts before 1980 as "infrequent" and small in scale). *See also* Marc Moore & Chris Hale, *Private Equity's Neglected Pre-History: A Trans-Atlantic Perspective* (March 27, 2024), ssrn.com/abstract=4774618 (tracing the long evolution of LBOs and their close counterparts).

40 *See, e.g.,* Atif Azher, Simpson Thacher & Bartlett LLP: Private Equity (Transactions) 2024, March 8, 2024, https://www.stblaw.com/docs/default-source/related-link-pdfs/simpson-thacher_lexology-panoramic-private-equity-2024.pdf (in 2023, for example, PE deals accounted for 38 percent by value of all M&A activity); FTI Consulting, *Private Equity is Adapting to Shifting Market Dynamics* (June 16, 2025), https://www.fticonsulting.com/insights/articles/private-equity-adapting-shifting-market-dynamics ("PE-sponsored buyouts (excluding bolt-on acquisitions) have accounted for nearly 35% of global M&A activity by deal count this decade … compared to 26% from 2013-2019 and 23% a decade ago.").

41 Antoine Garar & Alexandra Heal, *Private equity industry shrinks for the first time in decades*, FIN. TIMES, March 4, 2025 ("Buyout firms managed $4.7 trillion in assets as of June last year… according to a report from consultancy Bain & Co.).

42 The number of public companies has steadily declined. *See, e.g.,* Craig Doidge, George Andrew Karolyi, Kris Shen & Rene M. Stulz, *Are there too Few Publicly Listed Firms in the US?* (March 03, 2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5163070. The "decline of the public corporation" was noted in Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61, 61-62 [hereinafter, Jensen, *Eclipse*]. For recent contributions on this ongoing trend, see Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L. J. 445 (2017) (examining "the decline of public equity") and Mark J. Roe & Charles C.Y. Wang, *Half the Firms, Double the Profits: Public Firms' Transformation*, 1996-2022, 2 J.L. FIN. & ACCT. 211 (2025) (challenging the notion that public markets have declined in size).

43 *See* Andrew F. Tuch, *The Remaking of Wall Street*, 7 HARV. BUS. L. REV., 315, 350 (2017). (examining the post-2008 transformation of private equity firms and growth of credit funds).

44 *See, e.g.,* Alexander Saeedy, *Jamie Dimon Says Private Credit is Dangerous—and He Wants JPMorgan to Get in on It*, WALL STREET J., July 13, 2025.

45 As to the origins of this trend, see Jensen, *Eclipse*, *supra* note 42 (describing "the privatization of equity" in the 1980s).

between contracting parties.[46] An extensive literature examines settings characterized by such repeat playerism,[47] exploring the role of informal enforcement mechanisms—for instance, loss of reputation within the community or loss of future business or social opportunities.[48] Another strand of scholarship examines the conflicts and other principal-agent problems facing professional advisors in M&A.[49] However, neither strand of scholarship has addressed the world of bake-offs.[50]

In the next section, we discuss bake-offs in detail, introducing designation, the practice by which lenders' lawyers are appointed. Later, we consider the forces that sustain this arrangement and its implications for theory and practice.

II. THE BAKE-OFF

We now turn to the heart of our article: a discussion of borrower-designated lenders' counsel, or designation. Relying both on literature from practitioners' publications and interview evidence, we bring into the legal-academic discussion a nuanced description of this practice. This sets the stage

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[46] *See* Part II, *infra.*

[47] *See, e.g.,* Jonathan M. Barnett, *Hollywood Deals: Soft Contracts for Hard Markets*, 64 DUKE L.J. 605, 607 (2015) (discussing the use of non-binding agreements—or "soft contracts"—in modern Hollywood filmmaking) Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J.L. ANALYSIS 561, 562 (2015) (describing how original equipment manufacturers in the Midwest have used a mix of formal contracts, relational contracts, and other tools to build and support their business relationships); Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981, 987 (describing the way in which commercial contracting parties across a variety of industries use a mix of formal and informal contracts to support their business relationships); Robert C. Ellickson, *A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry*, 5 J.L. ECON. & ORG. 83, 84 (1989) (presenting evidence of informal enforcement—norms—overtaking formal enforcement in the whaling industry).

[48] Cathy Hwang, *Collaborative Intent*, 108 VA. L. REV. 665, 670 (2022). As to the reputational constraints for repeat players, "poor behavior in one transaction will sully their future transactions—a result many individuals wish to avoid." Cathy Hwang, *Faux Contracts*, 105 VA. L. REV. 1025, 1031 (2019).

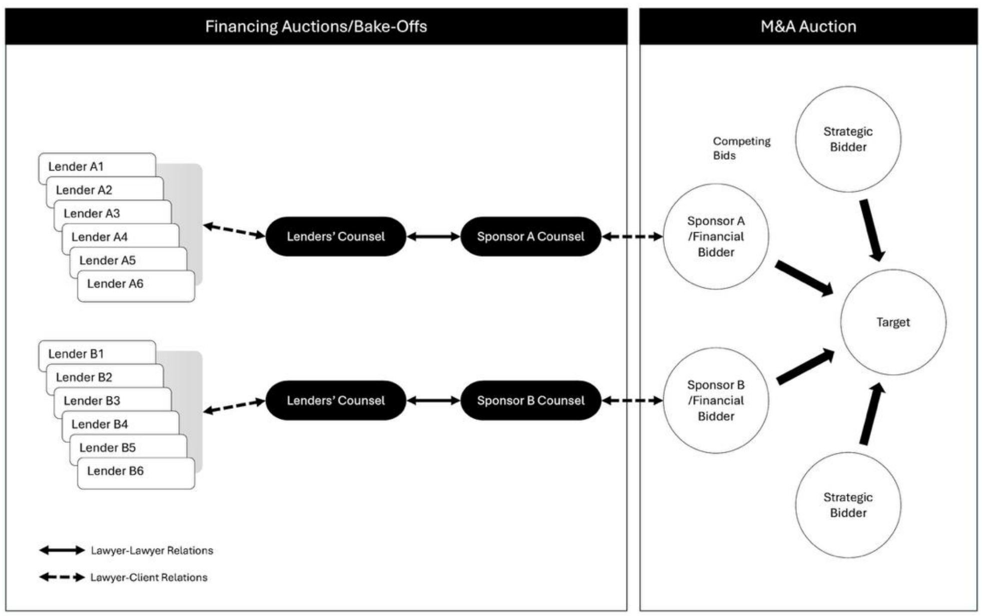
[49] *See, e.g.,* William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEXAS L. REV. 1 (2014) (examining financial advisor's conflicts); Marc I. Steinberg, *Counsel Conflict Dilemmas in Mergers and Acquisitions*, 47 S. TEXAS L. REV. 3 (2005) (proposing a framework for assessing lawyers' conflicts in M&A); Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079 (2016) (critiquing arm's length characterizations of M&A advisors and developing a framework for assessing M&A advisor liability).

[50] As noted above, Clark examines similar practices in the United Kingdom. *See supra* note 20. Recent scholarship has examined the repeat-play nature of private-equity transactions, although it focuses on contractual relations among sponsors and their investors. *See* Kobi Kastiel & Yaron Nili, *Opting Out of Court? Reputation and Informal Norms in Private Equity*, VAND. L. REV. (forthcoming), ssrn.com/abstract=5407006.

for Part III, where we consider the reasons this practice exists, and Part IV, in which we consider its many implications for theory and practice.

Through a lender auction or bake-off process, the sponsor selects the lender or lenders that will finance the LBO bid on the most sponsor-friendly terms, accounting for interest rates, financial covenants, and so on.[51] Sponsors may invite a dozen or more lenders to a bake-off.[52] Some sponsors have a lead lender in mind before the process begins and invite multiple lenders to "juice the competitive dynamic."[53] Others may not have a preferred lender before they begin.

We illustrate this process in Figure 1:



In the course of the bake-off, borrowers will generally select the lenders' counsel. A single law firm, chosen by the sponsor, then represents all lenders vying to be lead lender.[54] This is a notable departure from the norm prevailing

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[51] As to the types of lenders and common terms, see Cathy Hwang, Yaron Nili & Jeremy McClane, *The Lost Promise of Private Ordering*, 109 CORNELL L. REV. 1, 32-41 (2024).

[52] The number of lenders may be determined by the target since the more lenders there are, the greater the risk that a deal will leak. Lenders concerned about confidentiality of sale talks may restrict the number of lenders sponsors may invite to a bakeoff. (PLI 2024 at 3). Dual-track auctions, in which groups of syndicated and direct lenders compete among themselves before the winners compete against each other, are increasingly common.

[53] Lawyer #4.

[54] Commitment papers limits sponsors' obligation to pay legal fees "to one legal counsel for all financing sources." Lauren Hanrahan & Christopher Kwan, with Practical Law Finance, Sponsor/Lender Negotiating Considerations in US Acquisition Finance—Commitment Letters, Westlaw (noting exceptions for local and regulatory counsel and additional counsel required due to conflicts of interest). The lead lender "will have 'left placement' on the commitment letter to

in virtually all other areas of corporate practice, in which each party selects its own counsel.[55] Yet it is de rigueur in private equity LBOs.

As one lawyer puts it, "There are very few instances where the bank in an auction can designate its own counsel."[56] Another observes, "Designations have become almost ubiquitous. We certainly have clients that don't designate a lender counsel, but I think that [*sic*] rule at this point is that most sponsors do designate counsel."[57] Sponsors can, and sometimes do, offer lenders a list of three or four law firms to choose from. But common practice is to designate the counsel without input from lenders.[58] Hence, one lender explains, "[T]hese days, the sponsors will give us one choice, and if we aren't happy with it, we lose the deal."[59]

It is worth emphasizing, too, that while having a preference for one's counterparty's counsel is not unheard of, the *designation* process, achieved alongside a bake-off for business, is relatively unique to sponsors involved in LBOs. As one interviewee put it, "designation of lender counsel by borrowers is really just for sponsor financings and typically in the acquisition context."[60] According to another interviewee, designation outside of this context "does happen," but "less often."[61] As they noted, "you see it because corporates do acquisitions too, but often they have stronger incumbent lending relationships. . . . So there's probably a counsel who's already around the hoop. So those are the people you'd go to. It [designation] can happen."[62]

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indicate its primary status among other agent banks." Practical Law Finance, Commitment Letters Overview: Lending—Titles and Roles (Westlaw). As a lead lender, the lender "will have the main responsibility for negotiating the commitment letter and the other terms of the transaction." Practical Law Finance, Commitment Letters Overview: Lending – Parties Making the Commitments, Westlaw ("Typically, one bank will act as the lead bank and will have the main responsibility for negotiating the commitment letter and the other terms of the transaction.").

[55] *See infra* notes 60 - 62 and accompanying text.

[56] Practising Law Institute, *Leveraged Financing: Ethics*, 4 (2018).

[57] Practising Law Institute, *Leveraged Financing*, *supra* note 56.

[58] New York State Bar Association Committee on Professional Ethics, Opinion 1183 (03/10/2020), 1 ("[T]he [sponsor's] designation of the [lenders'] counsel … is made by the law firm representing the recipients.").

[59] Bakie, *supra* note 14. An Opinion by the New York State Bar Association describes the practice similarly: "[I]t is not uncommon for the [sponsors] (or their counsel) to maintain lists of designated counsel to act on behalf of the funders, the use of which counsel is a condition precedent to the recipients' willingness to transact business with the funders."). New York State Bar Association Committee on Professional Ethics, Opinion 1183 (03/10/2020), 1.

[60] Lawyer #21.

[61] Lawyer #18.

[62] *Id.* The interviewee noted, however, that corporate borrowers are unlikely to conduct a bake-off among potential lenders since they are likely to already have preferred lenders from which they intend to borrow.

Since the designated law firm represents multiple lenders vying with each other, it erects internal ethical walls to mitigate the misuse of confidential client information. Each lender works with its own distinct team of lawyers within the designated law firm.[63] These teams are known as "trees."[64] A separate "central" tree conducts due diligence on the target company and shares that information with all of the lender trees; the lender trees are otherwise intended to be walled off from each other.[65]

The bake-off between lenders to lend money involves back-and-forth negotiations between the sponsor's counsel and the trees. Typically, the auction begins with the sponsor providing lenders a terms grid, which outlines the sponsor's financing needs and preferred lending terms.[66] Lenders, through designated counsel, negotiate those terms without information being shared between the trees.[67] As the process continues, some lenders may withdraw or be dismissed by the sponsor.[68]

The process is, in general, a competitive one. "Sometimes the sponsor knows who the likely lead lender is [before the bakeoff begins]," one practitioner explains. "They don't come into it blind."[69] but as another practitioner notes, "[Sponsors] use this bake-off process to optimize [the lending terms]. You don't just pick one or two [lenders] up front, you let them show you what you can do."[70] One interviewee told us,

> "You want to know who is going to give the best terms—interest rate, covenants, baskets, etc. . . . and then put them next to each other. You go through them, and you send out revised

[63] Benjamin Cheng, with Practical Law Finance, Designated Lender Counsel Arrangements (Westlaw) (2016), at 2; Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing*, 3 (2024).
[64] *Id.* at 2. Lenders may similarly be participating in multiple bake-offers and will use ethical walls between their teams, apparently. *Id.* ("Many banks are familiar with this process [ethical walls used between trees within designated lenders counsel] and frequently use a similar internal arrangement when multiple issuers or equity sponsors are separately soliciting financing proposals for the same target.").
[65] *Id.*
[66] Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing*, 4 (2018).
[67] Cheng, *supra* note 63, at 2 ("To keep the process competitive, the designated lender counsel's attorneys on different trees do not share with each other the commercial terms of the debt commitment proposals from their respective bank clients."; Lawyer #4 ("We're not showing them what other people [lenders] say."
[68] Cheng, *supra* note 63, at 2 ("To keep the process competitive, the designated lender counsel's attorneys on different trees do not share with each other the commercial terms of the debt commitment proposals from their respective bank clients."; Lawyer #4 ("We're not showing them what other people [lenders] say." Lawyer #4
[69] Lawyer #4. This interview added, "Sometimes that [lender's] tree doesn't win, but for relationship reasons, you want that to go ahead." Lawyer #4.
[70] Lawyer #7.

grids. You send out various messages, you call the person who is way behind, and you say you guys are way off spec. . . . You do a few rounds."[71]

The sponsor generally provides potential lenders with the first draft of the commitment papers. This is a departure from the prior practice, which saw lenders drawing up those drafts.[72] These papers set out the terms on which more detailed lending documents will be prepared if the sponsor wins the M&A auction. Included in the commitment papers will be a debt commitment letter,[73] a document that the sponsor will present to the target company along with the sponsor's bid in the main (M&A) auction.

Each lender, through its tree, is asked to comment on the proposed terms, but lenders' counsel often keep their comments to a minimum, knowing that extensive comments will weaken their competitive position.

While the lending trees do their work, the central tree undertakes due diligence on the target, acquiring nonpublic information from the sponsor about the target and making it available to each of the potential lenders. Lenders may participate in due diligence by asking questions of the sponsor or sponsor's counsel, and many sponsors provide a due diligence memorandum disclosing information relevant to the target's financial prospects. However, lenders must typically sign a non-reliance agreement, attesting as a condition of receiving the memorandum that the sponsor is not liable for misrepresentations it might contain.[74]

Ultimately, the sponsor seeks to secure lenders willing to provide finance on the most sponsor-friendly terms while imposing the fewest possible conditions to lending. That is because the cost of debt influences the price the sponsor can offer the target. From an M&A target's perspective, conditions to lending increase the risk that the lender will not actually fund the loan, so if a sponsor can present a lender who has fewer conditions on the debt, that will also increase the sponsor's chance of winning the M&A bid.[75] The terms

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[71] Lawyer #4.
[72] *See* Lauren Hanrahan & Christopher Kwan, with Practical Law Finance, Sponsor/Lender Negotiating Considerations in US Acquisition Finance – Who Has the Bargaining Power?, Westlaw ("Counsel to top-tier sponsors often prepare the first draft of their commitment papers and loan documents and then deliver them to the financing sources (rather than following the prior practice of having the financing sources' counsel take the lead. On drafting the documents.").
[73] Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing*, 4 (2018).
[74] Practising Law Institute, *Leveraged Financing: Financing an Acquisition Using Leveraged Financing*, 4 (2024).
[75] *Id.*; Practical Law Finance, Commitment Letters Overview: Lending, Westlaw ("Borrowers need to rely on the money being available, so they want as few obligations and conditions to lending as possible to minimize the risk that the lender will not fund the loan. This is particularly

indicated in the debt commitment letter are therefore critically important and help to determine the attractiveness of the sponsor's M&A bid.

For lenders, too, the bake-off is a high-stakes transaction. The bake-off identifies the lead lender, which typically commits to the bulk of the loan.[76] Other lenders may commit, but only "on a reduced basis,"[77] taking a smaller proportion of the loan or serving in another capacity.[78] Winning the bake-off, then, means the right to lend more, earn more in fees, and gain bragging rights that may lead to more business in the future.

If the sponsor does not win the bid, then the sponsor walks away from both the M&A deal and the lending deal. This means that neither the sponsor nor the lenders earn any money on the deal—and, as we will discuss in the next Part, neither does the lenders' counsel.

If the sponsor does win, however, the final step is to prepare loan documents for the LBO—detailed papers reflecting the terms agreed in the commitment papers.[79] During this process, the winning lender continues to be represented by its designated counsel. The trees representing the non-winning lenders are no longer part of the conversation, but the central diligence tree and the winning lender's tree merge and work together to negotiate the rest of the deal.[80] Of interest is the fact that many of the non-lead lenders will also join the

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the case for acquisition financings where a buyer may be one of several parties bidding to acquire a target company.").

76 While the process aims to identify the best terms, sponsors are also mindful of preserving relationships with lenders, hoping they will participate in future bake-offs. As one interviewee explains,

> If you go to six potential providers and make them go through diligence, it's not the greatest idea to say at the end 'you're out' … Oftentimes the financing provider with the best terms will get "lead left" credit which is meaningful, [but] others will get a chance to participate. It's basically rewarding them for the work that they did. It's art more than science. (Lawyer #7).

77 Interview Lawyer #3. (They may "still [be] a lead arranger and … still get economics, but [they] might not get league table credit. They're not lead left. They still participate in a deal but on a reduced basis."); Lawyer #1 ("[E]ventually one will win [the bakeoff]… but in almost all cases, there will be room for other banks who didn't win the competition to participate on the deal as term takers.").

78 "The lead will take 40% and others will take 20% or something like that." Lawyer #4.

79 Benjamin Cheng, with Practical Law Finance, Designated Lender Counsel Arrangements (Westlaw) (2016), at 3 ("[T]he tasks of negotiating the credit documents and managing the closing will be handled by one team of the designated lender counsels attorneys dedicated to advising and servicing the left lead arranger in that process. It is oftentimes the same team that represented that bank in the initial stage when it was competing with the other banks for the left lead title.").

80 Lawyer #1 ("Once you choose your left lead bank . . . you collapse the trees. . . . . It becomes the tree that's working for the left lead [the winner] and the central tree that . . . work together.").

deal, providing smaller fractions of the lending, with the lenders' counsel then representing the lending group.[81]

After funding is provided—which may be months after the bake-off—sponsors pay the designated counsel's fees, compensating the law firm for representing all lenders in the bake-off—those successful and those not[82]—and for its role in acting on behalf of the successful lenders in ultimately funding the LBO.

* * *

The practice of counsel designation raises many questions. Chief among them is *why* the practice exists. While this Part has documented the nuances of the practice primarily through a careful reading of the practitioners' literature, the next Part relies more heavily on evidence gathered from original interviews with practicing lawyers to probe the motivations behind this practice.

III. WHY DESIGNATION OCCURS: EVIDENCE FROM INTERVIEWS

There are several reasons the practice of designation thrives. In this Part, we draw on interviews with borrower- and lender-side counsel to explain how an intricate web of norms, law-firm billing practices, lenders' financial incentives, and even lender rankings contribute to the use of this practice.

A. Efficiency

Interviewees uniformly reported that the industry uses designation because it is efficient.

Prior to the proliferation of designation, lenders each had their own counsel:

> There was a time when every bank would use their own counsel. And you might have an auction situation where [the sponsors] are going out to multiple banks . . . for bids and they would have different grids and they had counsel marking it up, seven counsel for seven banks. It became unwieldy.[83]

Shortly before the 2008 Financial Crisis, sponsors began to designate their lenders' counsel—first in the London market, and then in the U.S. market:

> Counsel designation started in London and got brought to the U.S. in 2006, 2007, pre-Financial Crisis timeline . . . . Pre-Crisis,

[81] *See* Practising Law Institute, *Ethical Considerations in Leveraged Financings* (May 21, 2025), at 2 ("And on syndicated deals, I think the answer is pretty clear that lender's counsel is not representing the entire syndicate but they are representing the lead arranger at least, and maybe the arranger group more broadly").
[82] *See infra* Part III.C.
[83] Lawyer #10.

> ultimately you were working with counsel that the [lender] firms picked. . . . Sometimes you'd have multiple counsel. . . . Frankly, starting with deals . . . in 2006 and all those big deals leading up to the Crisis, that's when sponsors took over drafting the documents. . . . Part and parcel of that was [selecting] counsel. After the Financial Crisis, that paradigm stuck.[84]

A desire to do deals more efficiently, interviewees reported, led to the proliferation of designations. Numerous times in interviews, they reported that short deal timelines, as well as the desire to be cost-efficient, are the primary drivers of this practice.

Hiring a single law firm to represent all potential lenders saves both money and time, allowing sponsors to meet aggressive M&A auction timelines. In particular, the tree structure is beneficial because there need be only one team conducting due diligence. Then, that central "diligence tree" shares its findings with each of the individual lenders' trees. This eliminates the need for each of the lenders' teams to conduct their own due diligence.

As one sponsor-side lawyer puts it:

> In order to make this process more streamlined and more efficient, it's easier if one counsel [takes the lead] and has a central tree for diligence, and different trees for each financing source. It's primarily efficiency. It's much harder to do this process if you have different law firms for each of the providers.[85]

Another lawyer, also pointing to the cost and time savings of designation, tells us:

> My view is that designation does streamline diligence. Not only the expense of diligence but also the time. Right now, being in the sponsor's shoes, in order to win deals, especially good deals that are rated well, sponsors have to move so quickly. They don't have time to have five or six lenders do their own diligence. They have to do it within a very compressed timeline. They are really scrunched for time.[86]

A lender-side lawyer gives more detail on the cost savings of designating lenders' counsel, explaining:

> We always ballpark how much it costs to get to a signed set of commitment papers . . . between $75-100K per tree. And there's

[84] Lawyer #20.
[85] Lawyer #7.
[86] Lawyer #8.

> an additional $100K of time on the diligence tree. If you had [no central tree] that would be an additional $100K borne by each tree for due diligence. There are the common work products that I think drive efficiency.[87]

This lawyer also notes the efficiency benefits of pairing the same sponsor- and lender-side counsel on deal after deal:

> Let's say I've done twenty deals opposite [law firm name] for [sponsor name]. Put aside the business stuff. The legal stuff . . . we've already negotiated over the course of twenty deals, and we've gotten comfortable over the language. There are real efficiencies . . . . If you have five different firms on these deals, [then you're renegotiating]. . . . There is a trust element as well. With good relationships, you can trouble-shoot issues."[88]

Another practitioner puts it this way:

> You want to get [lenders' representation] into the hands of people who, first, know the market and are doing it all the time—know the terms, can act quickly, can handle the trees. There are very few firms [that can handle the process]. . . . . If you get the wrong person, they are going to go back and recreate the atom, but there's just not time for that. . . .
>
> If you have to go back and negotiate first principles on things that are battle-tested, the bill's going to be $3 million instead of $1 million, and that's not going to be good for anybody. . . .
>
> That's why it's more efficiency than anything. It's also comfort. If I've designated lawyer X four times, chances are we're going to get to a good place the fifth time. . . . [Y]ou're required to go very fast. You don't have time to recreate the wheel.[89]

Repeating the theme, another practitioner explains that designation "is less about us influencing lender counsel. It's driven by efficiency and the short timeline." With the right lender's counsel in place, "we can get through this in a couple of weeks."[90]

B. Sponsors' Superior Bargaining Power

One common thread that ran through many interviews is that the private equity sponsors have superior bargaining power over lenders in these transactions, which helps to explain why lenders accept the practice of

[87] Lawyer #6.
[88] Lawyer #6.
[89] Lawyer #4.
[90] Lawyer #7.

designation. The sponsor is the party that chooses the lender—in general, there are many lenders willing to lend. As one lawyer put it, designation became the norm because sponsors "had the power [to designate] and they realized they had the power. . . . Banks needed them for league table credit."[91]

Another lawyer also noted that designation happens because sponsors can do it: "They [sponsors] dominate the market right now. And who wouldn't want to pick someone that they felt, you know, would be . . . 'user friendly' . . . on the other side?"[92]

Indeed, one interview participant, who usually represents lenders, described the process of designation as a "power play":

> About 15 years ago, we started to see some unusual "designations." Sponsors would go to the bank and say, "We're going to tell you who to use. And by the way, it's not going to be [Law Firm A] or [Law Firm B] [both often banks' preferred counsel]. It's going to [Law Firm C]. . . . I've talked to sponsors and sa[id], "How can you expect my client, who is [Prominent Bank], to use [Law Firm C]? And without batting an eye, they would say, "Because I can make them." It was a power play.[93]

And while many interview participants report that the process of choosing the designated lenders' law firm is not entirely sponsor-driven, almost all reported that sponsors are in the driver's seat. One interview participant summed up the designation process as a spectrum of negotiation, depending on the power of the sponsor:

> [The designation process] depends in part on the market power of the sponsor. So some sponsors are so powerful they'll just put it [the name of designated lenders' counsel] in the grid. More likely, though, it'll be some conversation where the sponsor will tell one or more of the relationship bankers, "We're planning on using so-and-so," "We are using so-and-so," or sometimes if they're less powerful, they'll go out to all five potential [ ] banks and say "Can you tell us which three firms you'd like to work with?" There are some deals where you really need [the banks'] money and you don't care [about which law firm they want to use]. It really is a spectrum of dynamics of how much you need the money and what law firm that institution uses,

[91] Lawyer #19.
[92] Lawyer #3.
[93] Lawyer #14.

> what the personality of the capital markets person is at the sponsor, what the personality of the sponsor finance is . . . "[94]

Another interviewee noted that while designations used to be more of a negotiation between sponsors and lenders, "now, if we [the sponsor's counsel] said you're going to use so and so, there's no conversation. The bank is going to use the counsel that we choose."[95]

Several interviewees reported that designation occurred as part of an ongoing evolution. Sponsors have gained more power over the last decade or so, which has evolved into a system where the sponsor not only encourages lenders to present good deal terms, but also forces lenders to use their forms—and, eventually, the sponsor's designated counsel. As one interviewee put it:

> As a general matter, there are way more people trying to lend money to sponsors than there are deals to invest in. . . . Lots of first principles have been abandoned . . . [The lenders'] choice is either to stick to their guns and say stick to these principles or [continue to do business]."[96]

Unsurprisingly, some interview participants reported that lenders, who are in the less powerful position, dislike the practice. One interview participant, for instance, said "The banks kind of hate it, . . . but frankly [designation] benefits the banks as well. They get to know [from designated lenders' counsel] what's market, they get well advised . . . But the banks think, 'am I really getting unbiased unfettered advice?'"[97]

Another noted that:

> A lot of banks really hated [designation] and a lot of the direct lenders hated it. 'How can we really be sure that you are fighting for our interests when our lawyers and the people who are paying our bills are on the other side?' . . . [But] even the lenders who didn't want to do [designation], eventually said [to their preferred lawyers] 'You've got to start pitching for designations, because we're getting counsel we don't like.' We went from resisting this phenomenon to our clients wanting us to do it.[98]

Another noted that some lenders had tried to push back on designation after the 2008 Financial Crisis but were unsuccessful. He reported, "[Lenders] announced they weren't going to be bossed around anymore, [that] after the Financial Crisis, power was going to flow back to them. But that didn't happen.

94 Lawyer #12.
95 Lawyer #16.
96 Lawyer #16.
97 Lawyer #20.
98 Lawyer #6.

Not only did it not happen, but the documents continued to flow [in favor of sponsors]."[99]

Participants report that direct lenders are similarly subject to the superior bargaining power of sponsors. These lenders initially bargained harder than banks and even opposed designation, perhaps a response to the fact that they retain loans on their balance sheets.[100] However, they, too, have succumbed to the bargaining power of sponsors. One interviewee explains,

> There's been so much capital coming into this [direct lending] industry and so much pressure to put the money out as loans.…So, you know, I will say like eight years ago when I was dealing with these direct lenders…it was a different experience than running through a bank process. Now it's been more of a merger [with the bank process]."[101]

This comports with a general trend over the past two decades in which loan terms have become increasingly borrower-friendly.[102] As one lawyer reports, in the past, "sponsors would ask lenders to give them an indicative term sheet," after which the sponsor's counsel would compare the different lender-drafted term sheets, seek additional commitment letters, and compare those different lender-drafted commitment letters.[103] But "then, borrower's counsel would have to look through various formulations of term sheets, commitment letters, and fee letters, and mark them up and give them to the lenders."

Over time, however, borrowers determined that there was an easier way, especially given their superior bargaining position: "How about this? I just give lenders my own form? So when I get them back, I'm comparing apples to apples."[104] From this first step of borrowers taking the drafting pen from lenders evolved a second step: "Now, when we go out and give a grid to lenders to respond to, one of the last little rows or boxes is always 'counsel.' . . . Even before we move to commitment paper negotiation, . . . one of the terms is counsel selection. We will have an agreement upfront on what counsel they think they are using and we think they are using."[105] Sponsors are said to have borrowed this practice from the capital markets space, where repeat issuers of

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[99] Lawyer #12.
[100] *See infra* Pt. III.E.
[101] Lawyer #21.
[102] Wachtell, Lipton, Rosen & Katz, *Financing Year in Review: Opportunity Knocks*, Jan. 31, 2025 ("The terms of debt financing documents have for the last 20 years been on a steady march in the direction of flexibility for borrowers.").
[103] Lawyer #8.
[104] Lawyer #8.
[105] Lawyer #8.

securities may designate counsel for underwriting syndicates,[106] although designation raises unique issues, as we describe below.[107]

If lenders oppose the designation practice, the consequence is often that they cannot participate in bake-offs. Yet the financial appeal of leveraged lending is such that lenders have accepted the terms sponsors offer. As one sponsor-side advisor put it, all the parties "know the drill."[108] They continue, "I can't even envision a situation where that would apply [a lender would refuse to participate in a bake-off because it was unhappy with the designated counsel] … . Absent extraordinary circumstances, where this bank was the only bank willing to make the loan, the sponsor would just say you're going to use [the designated counsel]."

Interestingly, one interviewee who primarily represents sponsors in middle-market transactions noted that they have seen some successful pushback on this practice from lenders:

> Generally speaking, when we're talking about designation today, we're saying to the lenders, give us three firms [to choose from]. I do think the pendulum is swinging a bit . . . Lenders can put forth up to three counsel. The sponsor will still designate, like, "Out of these three, we'll pick one of these."[109]

C. Fee Structures

How sponsors, lenders, and counsel are compensated also plays an important role in explaining the practice.

As a norm, "the company pays the lenders' counsel expenses."[110] Since "the company" refers to the target company that is eventually owned by the

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[106] Lawyer #6, Lawyer #8. For more on the impact of designated underwriters' counsel, *see* Michael Bradley, Irving De Lira Salvarierra & Mitu Gulati, *Lawyers: Gatekeepers of the Sovereign Debt Market?*, 38 INT'L REV. L. & ECON. 150 (2014).
[107] *See infra* Pt. IV.A.
[108] Lawyer #16.
[109] Lawyer #8.
[110] Lawyer #11. *See also* Lawyer #1 (noting that if all goes well, the sponsor pays the fees). As to the sponsor's obligation to pay lenders' legal fees, see Practical Law Finance, *Commitment Letters Overview: Lending—Expenses and Indemnification*, Westlaw (commitment letters generally require borrowers to cover lenders' legal fees). The commitment letter is signed by lenders at the time the M&A bid is lodged, committing them to fund the proposed transaction on the terms specified, but is not countersigned by the sponsor unless it wins the bid. Lawyer #1 ("As part of the milestones in the bid process, you'll provide a partially binding commitment letter. [When it becomes a binding commit letter,] that's when the [obligation to pay lenders' legal expenses] comes into effect. You as the sponsor wouldn't countersign the commitment letter . . . until you win the bid."). *See also* Lauren Hanrahan & Christopher Kwan, with Practical Law Finance, Sponsor/Lender Negotiating Considerations in US Acquisition Finance – Expenses and Indemnification, Westlaw ("Sponsors typically do not pay for the out-of-pocket expenses (including legal fees) of the financing sources unless the deal closes.").

sponsor—the portfolio company—if the sponsor wins the M&A auction, this means that the sponsor and its investors—that is, the relevant private equity fund—are the ones who ultimately pay the lenders' legal bill.[111] Since sponsors receive a generous share of the profits the fund generates, they have powerful incentives to minimize legal fees.[112]

If the sponsor does not win the deal, then lenders' counsel is generally not entitled to payment:

> Sponsors that have the most negotiating leverage will say, "We only pay the winner, and we only pay the winner if we close [on the M&A deal]." . . . The sponsor with the most power will say "We don't get paid before we close [the M&A deal]" The next tier is "You get paid if we select you to lead the financing." . . . In the lower middle market, you've got lenders still asking for work deposits. . . . This is all along a spectrum."[113]

Asked whether this means that designated counsel may go uncompensated for some deals, one interviewee agreed, saying "[designated counsel] are entitled to nothing" if the sponsor's bid fails.[114] Lenders might choose to cover part of designated counsel's fee in these circumstances, although "that is very rare."[115]

Another practitioner put it this way: "[the time incurred by designated counsel] . . . gets eaten in the name of good faith. Other times, depending on the relationship and the banks involved, sometimes something gets paid from the banks."[116] One lawyer noted that "On [a] failed bid, sometimes lenders kick in [to pay the law firm]. It depends on the engagement letter."[117]

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[111] DEBEVOISE & PLIMPTON, PRIVATE FUNDS: KEY BUSINESS, LEGAL AND TAX ISSUES 60 (2025) ("Out-of-Pocket Expenses of Completed Portfolio Transactions … are typically capitalized into transaction costs and are accordingly borne by the fund."). The fund, in turn, is owned by the sponsor, which will often contribute between one and five percent of the capital, and other investors. *Id.* at 1-5, 62.

[112] *Id.* at 45 ("Typically, the [sponsor] receives carried interest equal to a specified percentage of a fund's cumulative net profits (for a buyout fund, typically 20%).").

[113] Lawyer #8.

[114] Lawyer #4.

[115] Lawyer #4.

[116] Lawyer #1; "Sponsors don't cover broken deals. [For DLC], broken deal arrangements aren't covered." Lawyer #7.

[117] Lawyer #11. Our lender-side interview participants disclosed little about the terms of engagement letters with lenders, other than that their firms typically had "standing" engagement letters with these clients, many agreed years in advance.

As one practitioner puts it, "The [designated] law firms like [designation] because if you get the deal done, the law firm gets paid."[118] According to another interviewee on the lender-side,

> There's an economic reality that the banks will appreciate. . . . If firms like mine go back to a non-designation model, every time I go for a run on a deal, . . . the chance of success on a deal is that much lower. If that's the economics, then I'm going to have to charge the banks for my time. Whereas the way the model works today, if I'm getting all ten banks [participating in the bake-off] and my chances are one in five because there are five sponsors [competing for the target], then our volume is such that we can write off [if the sponsor doesn't win the M&A auction].[119]

Put differently, lenders' counsel is more likely to be compensated (by sponsors) under the designation model than the alternative because—by representing all lenders—their firm is assured of payment if the sponsor wins the M&A auction. Under the alternative, lenders' counsel gets paid *only* if the sponsor wins and *only* if their client—one of the competing lenders—is selected to participate in the loan.

Being designated as lenders' counsel in multiple deals also means that law firms develop stronger relationships with sponsors, increasing the likelihood that law firms are paid even for failed deals. One interviewee reported, for instance, that "Some sponsors will take the view that even though technically they don't need to pay the designated counsel, they will say, 'Send me the bill and I'll pay you half or something.' [It's] based on relationship."[120]

And, of course, when a sponsor does win, the bills are large. But to have the chance to win big, counsel must be involved in many deals as designated lenders' counsel: "When they hit, they're big bills. They're seven-figure bills. People think they're going to do better than they will. . . . You do it to stay in the game, you do it for the flow. . . . You can't gamble randomly."[121]

Indeed, when the same firm is chosen by a sponsor to be designated counsel on multiple different deals involving multiple different lenders, they may be able to make up for past failed deals when a deal finally succeeds. As one interviewee noted, "[L]enders counsel might fluff the final bill to make up for a failed bid. You should not be doing that. Sponsors can ask for more detail. But

[118] Lawyer #4.
[119] Lawyer #6.
[120] Lawyer #10.
[121] Lawyer #18.

we do not send itemized bills to third party payers for privilege reasons."[122] This participant noted that "You should not do that, but I know people that do."[123]

Another lawyer agreed that designated firms may bill fluidly once a deal is successful. They noted that when there is a successful deal, "Some sponsors will pay for the trees that are participating [in the loan]. But maybe of the six lenders that we started talking to, only four are going to be in the deal. Some sponsors will pay all six. Some will say they are paying for four and will pay for four. Some will say they are paying for four, but the lender law firm will bill them for six anyway. The billing is not black and white."[124]

Some sponsors are conscious that designated counsel should be compensated in some way for failed deals. One sponsor-side lawyer, whose firm typically designates either of two firms as lenders' counsel, explained, "at the end of the day, we want to make sure both those firms are well fed."[125]

For designated lenders' counsel, designation is a gateway to more deals with more fees, which may explain their preparedness to forego fees in unsuccessful deals. As one interviewee explained, "If we get designated on a new deal, if it's a decent-sized acquisition financing, the bill is going to be $1-2 million just on that deal. But then there's the follow-on. The follow-on business is multiple millions. It's amendments, dividend recaps, tuck-in acquisitions, bond deals, [and] any IPO. If you look on a more portfolio-wide basis . . . those portfolio companies are just doing a lot. It's many more millions."[126]

Lenders' compensation practices also matter. They are well compensated for arranging loans and for the amounts they lend. A *New York Times* article on designation noted, "Bankers and their in-house lawyers privately complain [about the practice] . . . [b]ut given the pressure to secure these big loan deals—which can be worth tens or hundreds of millions of dollars in fees—few are willing to publicly criticize the practice."[127]

D. League Tables & Banker Business Development

Beyond immediate financial remuneration from the deal at hand, how banks and direct lenders are recognized within their industry also contributes to the proliferation of designation. This applies especially in banking, where intense

[122] Lawyer #11.
[123] Lawyer #11.
[124] Lawyer #12.
[125] Lawyer #21.
[126] Lawyer #6.
[127] Sorkin, *A Growing Conflict in Wall Street Buyouts*, *supra* note 13. These powerful incentives have been judicially recognized. *See, e.g.*, RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 831, 855 (Del. 2015), aff'd, 88 A.3d 58 (Del. Ch. 2014), aff'd 102 A.3d 205 (Del. Ch. 2014) (bank repeatedly pitched its services to sponsor, hoping to receive $55 million from financing fees, more than 10 times the M&A advisory fee it would earn).

competition motivates banks to compete on terms during the bake-off—and to accept terms, such as counsel designation, that may not be optimal for them.

Banks gain recognition within their industry by rising in the bank "league tables." League table rankings are based on several factors, including whether a bank is in the lead left position (i.e., the leader of several lenders involved in the deal), the value of deals during the year, the fees generated, the types of deals that banks have been involved in.[128] As a result, being the lead left lender allows the bank to maximize some of those statistics, thereby increasing their position in the league tables.[129] A high ranking provides bragging rights, which banks rely on when they pitch clients for their business or promote their business to shareholders.[130]

Lead left status is very important for lenders. One interviewee, for instance, noted that simply participating in the deal but not getting lead left credit was suboptimal: "You still get the economics, but you might not [get] league table credit. . . . They [the banks] still participate in the deal but on a reduced basis."[131]

Against this backdrop, lenders are motivated to compete amongst themselves to become the lead left lender in a bakeoff. As an interviewee who primarily represents sponsors put it, "To get the best deal for my sponsor, I've got to create competition. I've got to have multiple parties competing to be lead left, to provide financing on the best terms."[132] Another interviewee reported that "Oftentimes, the financing provider with the best terms will get lead left credit, which is meaningful, [but] others will get a chance to participate. It's basically rewarding [the lead left] for the work that they did."[133]

Among the ways that a lender competes for business from the sponsor is by being willing to accept counsel designation. As one interviewee put it,

> [The banks] are each trying to get lead left. As private equity grew and [sponsors] could choose who they wanted . . . the leverage shifted and sponsors had more control. . . . So sponsors

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128 Will Kenton, *League Table: What It Is, How It Works, Example*, INVESTOPEDIA.COM (MAY 12, 2022), https://markets.ft.com/data/league-tables/tables-and-trends; *League* Tables, FIN. TIMES, available at https://markets.ft.com/data/league-tables/tables-and-trends/ (last visited Feb. 16, 2025). *See also* Lawyer #12 (reporting that league tables are based in part on how many times a bank is on the left and how many times they were an arranger at all).

129 *Id.*

130 *Id.* As an example of the latter, see BANK OF AMERICA, ANNUAL REPORT 2024, at 29 (referring to 2024 ranking by Dealogic for "leveraged finance capital raised.").

131 Lawyer #3.

132 Lawyer #12.

133 Lawyer #7.

started to say "You lender, if you want to be in this deal, you have to use [Law Firm name]."[134]

Because of their desire to be competitive in the bake-off process, and their desire to win the lead left position, lenders have added incentive to accept a borrower-designated counsel.

E. Syndication

The structure of the syndicated debt market—in particular, who ultimately holds the risk associated with the loan—also helps to explain why designation thrives.

After the initial lending transaction has closed, the initial lending banks use an "originate to distribute" model in which they almost immediately sell their debt downstream to other investors.[135] Because of the structure of this debt market, lenders generally do not hold the debt for long, instead quickly selling it to others.[136] This means that what lenders seek—and what lenders' counsel is really negotiating for—are loan terms that are good enough to be sold downstream to other debtholders.

As one interviewee put it, "A lot of this paper is sold in the market," so the lenders' counsel's "assessment is basically 'Will this clear the market?' If something has been seen in the market before and their client won't be hung [stuck] with the paper, they're typically fine incorporating that into the loan documents."[137]

Other interviewees reported the same. One remarked that "These guys [lenders] are really thinking 'What can we sell to the market?' not 'What do we have to take the risk on.'"[138] Another noted that "At the end of the day, lenders are just again focused on what they can sell."[139] Still another noted that what goes into the loan documentation is "what the banks think they can sell, not what they're comfortable with, not what they're comfortable holding on their own balance sheets."[140] To be sure, banks face credit risk once they sign commitment papers, one participant noted, but when they syndicate, "they just need to convince enough dumb buyers."[141]

The originate-to-distribute model leads to a world in which banks do not have the incentive to negotiate hard for lender-friendly terms, except to the

[134] Lawyer #10.
[135] Hwang, McClane & Nili, *supra* note 9, at 35.
[136] Lenders bear risk from the date they sign the commitment letters, but they seek to eliminate their exposure through syndication when the loan closes. Lawyer #21.
[137] Lawyer #21.
[138] Lawyer #20.
[139] Lawyer #19.
[140] Lawyer #1.
[141] Lawyer #21.

extent necessary to secure terms that will satisfy buyers in syndicated markets. And, indeed, because they sell the debt quickly to a dispersed market, what the market will bear is also a fairly standardized product—meaning that there is relatively little for lenders' counsel to negotiate.

As one interviewee explained, "This is how I think about it: . . . the forms are fairly standard among sponsors. It's trying to create a fairly commoditized product."[142] The result, then, is that many of the principal loan terms are quite similar, and there is a perception that lenders' counsel has relatively little to negotiate. Indeed, most syndicated debt documents are negotiated by reference with a precedent transaction. As one lawyer noted: "There's something called the document precedent. . . . You're kind of negotiating at the margins. It's all market-driven, it's practice-driven. And if you're designated counsel, a lot of it is 'I did this document precedent with [these terms].'"[143] Another noted that "You [ ] designate a precedent in the commitment papers and [the parties agree] . . . 'It's going to be like this deal and it's going to be no worse than this deal.'"[144]

In other words, the terms between the sponsor and lender are mostly settled before the bake-off, limiting the latitude available to counsel.[145] As one lender-side lawyer puts it, "It's not standardized, but there's a narrow band of issues [that we negotiate]."[146]

In short, lender banks are willing to live with designation because their primary motivation is to create a debt product that can be sold quickly downstream—which means that negotiating for very lender-friendly terms through aggressive lenders' counsel is not of high importance to them.

F. Conflicting Incentives & Industry Mitigation

i. The potential for conflicts

Many interviewees openly admitted that the practice of designation seems odd—given the conflicting incentives of designated counsel—to those who are not involved in the industry.

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142 Lawyer #12.
143 Lawyer #4.
144 Lawyer #19.
145 Designated counsel in the London market may have a similarly narrow understanding of their role. A similar threat operates in the London market. *See* Clark, *The Pendulum Swing*, *supra* note 1, at 47 ("[L]ender lawyers narrowly interpret their role; they confine themselves to identifying 'new' terms which have not previously 'cleared the market' in a previous transaction and which might prove an obstacle to a successful syndication.").
146 Lawyer #6.

One sponsor-side lawyer said, for instance, "Lenders might think, you just want to use your friend, that's who you're designating. So there's suspicion from lenders. The concept, it doesn't smell right."[147]

A lender-side counsel echoed this sentiment, adding that a concern is the deterioration in their relationships with clients. Clients, this practitioner explains,

> come to this relationship with a little tinge of suspicion—who are you really advocating for? That's really damaging to a relationship that's supposed to be really confidential. [When I started,] clients were the next best thing to friends. It's a bit more transactional than that [now]. I can't just say, 'This is the right answer to the problem,' because there's going to be a follow-up question, 'Why'd you say that? Is that really in my best interest?' For those of us who have been practicing for a while, that's a very clear shift and not one that I particularly like.[148]

And lenders have a basis for concern. Sponsors and their counsel have powerful incentives to designate counsel that will serve their interests, and interviewees give credence to these concerns. According to a sponsor-side lawyer, "Basically, their [designated counsel's] job is not to bust our chops too much when we ask for certain terms."[149]

As another sponsor-side lawyer puts it, designated lenders' counsel are selected on the basis of being "user-friendly"—that is, friendly to sponsors.[150] Another practitioner emphasizes that such counsel should be "easy to work with."[151] Yet another notes that sponsors, when considering whom to designate, ask themselves, "Who do you think you can play nice with?"[152] This interviewee adds that designation is focused on finding counsel who will provide the "smoothest ride" for the sponsor, while also giving banks "comfort."[153]

The anodyne language rather conceals what it means for lenders' counsel to be "friendly." Designated counsel have strong incentives to play along, too, because they are selected and paid by sponsors. We interviewed designated lenders' counsel who confirmed the pressure they experience—their recognition that they could lose their designation status if they are not sufficiently "friendly"

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[147] Lawyer #21.
[148] Lawyer #6.
[149] Lawyer #21.
[150] Lawyer #3. A similar threat operates in the London market. *See* Clark, *The Pendulum Swing*, *supra* note 1, at 47 ("As a result of designation, there is an implicit, and sometimes explicit, threat that the flow of instructions to a lender-side lawyer . . . if the [lawyer] proves 'difficult,' or does not take a 'commercial' stance, in the negotiation.").
[151] Lawyer #2.
[152] Lawyer #1.
[153] Lawyer #1.

from the perspective of the sponsor and its counsel. One lender's lawyer explains:

> In the designation paradigm that we live in, our job [as designated counsel] becomes how do we represent our clients in the way that they want to be represented while also ensuring that we're running a process that the sponsor can be satisfied with. . . . The shadow of the sponsor has to be having some kind of impact on the process. . . .
>
> The impact, I think, is very subtle but very real. If I have a set of papers 150 pages long, and I'm supposed to produce an issues list for my client. And if I put every single issue on the list, it'll be 10 pages long. . . . so I'm kind of curating that list [to highlight the important ones]. If I know that the sponsor's going to yell at me, does it cause me on these margin calls to think about whether to put things on the list or keep it off? Yes, it does. Nobody is doing anything wrong, but it's just human behavior. The sponsor might say you need to own this issue, especially if it's cleared the market (meaning that lender clients shouldn't be told about particular issues).[154]

This same lenders' counsel notes that the pressure is greatest when the designated law firm is dependent on the business of a small number of sponsors:

> Instead of producing that five to ten-page list that I mentioned, some other firms just produce a half-page list. That, to my mind, is where the designation model causes an issue. Where the entire practice at a firm depends on a small number of designations.[155]

ii. The penalty box

It is no surprise that lenders' counsel report feeling pressure under the designation model. Our interviews reveal mechanisms by which sponsors can discipline counsel who fail to toe the sponsor's line. To begin, sponsors are said to expect their counsel to report to them about designated counsel. One lawyer tells us,

> As sponsor's counsel, I will say '[name of law firm] was wonderful to work with, [different law firm] was awful to work with.' As sponsor's counsel, I'll give feedback not only on the law firm but also on individual partners.[156]

[154] Lawyer #6.
[155] *Id.*
[156] Lawyer #8.

Our interviews suggested an apparently shared, industry-wide understanding that lenders' counsel who behave poorly, from the perspective of sponsors and/or their counsel, might be put into "the penalty box"—an area next to an ice rink where a hockey player serves out a penalty.[157]

The first lawyer who alerted us to the terminology that designated lenders' counsel sometimes lose their designated status explained: "It's called being put in the penalty box. If the sponsor thinks you messed something up, . . . you can get put in the penalty box and not get designations. That happens with some frequency."[158]

Many other interviewees confirmed the use of the penalty box idea and even the terminology. A sponsor-side lawyer told us, "I know . . . certain sponsors have what they call a penalty box where if something happens on the deal . . . they do kind of sit them out."[159] When asked what counsel had to do to be put into the penalty box, they replied:

> That's where I think it's really tricky. The law firm did the right thing, quite honestly. They represented their client. It was a tricky situation, the lenders were initially a group and one [broke off]. [Others] felt like this lender and the counsel turned on them. It just created a bad blood situation.[160]

Sponsor's counsel reported that the penalty box could be used for lawyers who refuse to acquiesce to the sponsor's demands. According to another sponsor-side lawyer, "There are people who put people in the penalty box for not rolling over. I like to think we are more fair [than that]."[161]

Another sponsor-side lawyer explained,

> [Being put in the penalty box] occurs. [Designated lenders' counsel] are supposed to be pliant, subject to ethical rules, and there's subjectivity as to ethical standards.[162]

However, the penalty box is not just for lenders' counsel who do not do what the sponsors want—as one might fear—but also for those who compromise lenders' interests:

> I'm not accusing people [designated counsel] of being absolute hacks, but there are absolute hacks out there. They tend not to last too long. They may go from law firm to law firm, down in

157 Penalty Box, Merriam-Webster, https://www.merriam-webster.com/dictionary/penalty%20box (last visited Nov. 17, 2025)
158 Lawyer #6.
159 Lawyer #22.
160 *Id.*
161 Lawyer #16.
162 Lawyer #21.

rank. . . . [I]f you get a reputation for giving up clients' interests, that will eventually bite you. The successful people straddle the line. . . ."[163]

Other interviewees suggested that the penalty box did not compromise the loyalty of designated counsel, citing it as a measure to discipline counsel who—from the perspective of sponsors or their counsel—are unnecessarily expensive or impede dealmaking. One sponsor-side lawyer noted, "I like to think that I only put anybody in the penalty box for the reason any consumer of a service would put somebody in the penalty box…for making the process unnecessarily complicated, expensive or painful. . . . The market is pretty competitive. If you do a bad job, you'll get punished."[164] Still another described a situation where a lender firm sent the sponsor's counsel "three hundred comments" on a holiday and then didn't return the sponsor's counsel's calls. "When you talk about being put in the penalty box or not, it's not all like you're not rep-ing your client. It's about bad judgments. You're fighting about stuff you shouldn't be fighting about."[165]

Still others reported that the penalty box is not actually a wholly pro-sponsor power play, but an opportunity for sponsors *or lenders* to flag firms that are not proceeding in good faith or playing by market rules. As one lawyer noted, the penalty box concept "goes both ways—you can be put in the penalty box by the sponsors, but you can be put in the penalty box by the banks. The firms that are being designated are…also the firms that banks designate a lot."[166]

iii. Mitigating incentives

Countervailing incentives are also at work. Both sponsors and designated counsel also have incentives to ease lenders' concerns about the quality of designated counsel's representation. Consider that lenders wary about the service they receive from designated counsel may offer less favorable terms than they otherwise would, moderating designated counsel's otherwise-questionable loyalties. Relatedly, sponsors must be aware that lenders may also be participating in bake-offs for competing bidders in the M&A auction. If a sponsor insists that lenders accept counsel from disloyal lawyers, then the sponsor risks alienating these lenders, who may respond by offering more favorable terms to the sponsor's competitors. These forces help constrain sponsors from exploiting the conflicted loyalties of designated counsel.

Then, too, while designated counsel's financial incentives align with those of sponsors and their counsel, their financial incentives may also align with those of lenders. These lender clients are typically banks within large financial

[163] Lawyer #21.
[164] Lawyer #16.
[165] Lawyer #12.
[166] Lawyer #18.

conglomerates, which major law firms designated as lenders' counsel often represent, or wish to represent, in other transactions—for example, advising them as underwriters of securities offerings, as financial advisors on M&A deals, as primary deal participants, or in litigation and regulatory matters.[167] Some designated counsel surely have more to fear financially from betraying a bank lender client in a bake-off than from failing to be sufficiently "user-friendly" to sponsors.

The use of in-house counsel and external "shadow" counsel is another mechanism that mitigates designated counsel's conflicting incentives, helping explain why designation persists. These counsel provide advice in addition to the advice of designated lenders' counsel, thereby deterring disloyalty from the lenders' counsel and mitigating its effects. According to one practitioner, as shadow counsel, their firm "basically will look over the shoulder of designated counsel."[168] The downside is that lenders must pay out-of-pocket, but this lawyer explains:

> Particularly in regulated industries, I oftentimes find that our private credit funds [direct lenders] that are in a competitive lender auctions, will engage [law firm name] nonetheless, and "we don't care, we'll pay you." Lenders in particularly in highly regulated industries, . . . they're not shy to hire their own counsel and pay out of pocket.[169]

iv. The effect of conflicts

The extent to which lenders' counsel in fact succumb to temptation, skewing their representation of lenders due to the threat of sponsor blowback, is a more difficult matter. As one interviewee explains of designated counsel, "'Easy to work with' doesn't mean 'doesn't negotiate hard.'" [170] A lender-side lawyer says that they pride themselves on being "user-friendly" but adds that the client remains in charge: "If your client says, 'We can't do X,' then it's your obligation to pass that along," this lawyer affirms.[171] And a sponsor's counsel states, "I can think of many situations where we've been frustrated that [designated counsel] are digging their heels in, . . . but we're still paying them."[172]

[167] As to the financial appeal that financial conglomerates—financial services firms offering products and services in addition to lending—hold for major law firms, see Andrew F. Tuch, *Banker Loyalty in Mergers and Acquisitions*, 94 TEXAS L. REV. 1079, 1122-23 (2016).
[168] Lawyer #8.
[169] Lawyer #8.
[170] Lawyer #2.
[171] Lawyer #3.
[172] Lawyer #5.

This lawyer confirms, "My dealings with [designated counsel] [is that] they are raising issues that lenders care about."[173]

Nevertheless, our interviewees readily admitted that designation raised concerns among lenders.[174] They also suggest that designated counsel temper their actions under threat of sanction. As one sponsor-side lawyer put it, "It would be disingenuous of me to say there's no impact on the negotiation due to designation. It keeps [designated] lawyers from trying to be heroes and raising a million points [during the negotiation]."[175]

A lender-side lawyer tells us that, in the past, "lenders' counsel could be very difficult. And there weren't really any issues or consequences with that. Whereas now . . . everyone wants to get to a happy middle ground at the end. . . . I pride myself, for example, on being very 'market' and not being difficult."[176] To this lawyer, "not being difficult" is "a matter of emotional intelligence."[177]

Lender-side lawyers do not state directly that they have been coerced into sacrificing their clients' interests. But they do make clear that sponsors have the capacity to discipline designated counsel, and designated counsel knows this. With the sword of Damocles hanging over them, whom do designated counsel regard as their client? While their contractual and ethical duties run to the lenders, their business comes from sponsors.[178] One lawyer explains the tension this way:

> As a counsel for designated deals, who is my client? My client is the lender, but who's going to give me future work? . . . . It's going to be from the sponsor. Are they going to think I'm easy to work with? Practical? Sponsor-friendly? I think that's the real issue. It's not the current deal. I can do my very best on the current deal. I can go and be hard-charging. But it's where am I going to get that next deal? I think that is the problem.[179]

The marketing activities of designated counsel reveal the financial power of sponsors. Lenders' counsel build business with sponsors and sponsor's counsel as much as—if not more than—they do with lenders. As one interviewee put it, to be designated, "It all ultimately boils down to a combination of relationships and competency. Lenders' counsel spend an

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173 Lawyer #5.
174 *See, e.g.*, *Id.*
175 Lawyer #9.
176 Lawyer #3.
177 Lawyer #3.
178 The commitment papers—signed by the lenders and, if it wins the M&A bid, the sponsor-controlled entity—generally require the sponsor to cover lenders' counsel fees if funding is needed. (Interview with Lawyer #8). These expenses are included in the borrowed funds and "netted out" from the loan proceeds on closing. (Interview with Lawyer #8).
179 Lawyer #8.

enormous amount of time [doing lunches, networking] with sponsor's counsel and sponsors."[180] Another practitioner explains,

> When you ask lawyers who do a lot of sponsor designation, who are they visiting on their business tours, if you have a sponsor-designation practice, you're not just having meals and office visits with lender clients. I guarantee that you're also going to visit with the capital markets teams at the sponsor. . . . I think that is the crux. I think it creates pressure, because when you go and do your business development pitches, it's who you think is your client. The one you have an ethical commitment to is the lender. But when you go to travel and meet clients, I mean . . . it's industry standard that if you have that kind of practice, you're also meeting with the capital markets team of a PE firm.[181]

Sponsor-side lawyers confirm these dynamics. Designated counsel "know what side their bread is buttered on . . . and they want the next designation."[182] These lawyers "want to get to a place where [the bake-off] works," another sponsor-side lawyer explains, "so they are generally disinclined to be very difficult."[183] And not being difficult has consequences. "To be designated counsel suggests that you're doing less than if you were not designated," this lawyer offers. "The proof has been . . . that sponsors are getting better deals and the banks are bearing more risk. It's implied that the lender is [not getting as good a deal because of designation]."[184]

Empirical studies have not addressed the effects of designation, although a recent study of another type of potential conflict facing lenders' counsel suggests that they yield to temptation. Zhao, Chen, Cumming, and Zhao find that when a sponsor has a strong relationship with lenders' counsel, having previously represented that sponsor as sponsor's counsel, the resulting loan documents will have more sponsor-friendly dividend payout restrictions and fewer covenants.[185] While this study does not distinguish between deals with designated counsel and those without designation counsel—which is not observable to outsiders because of lack of disclosure about the practice of designation—it does raise concerns that lenders' counsel may succumb to

[180] Lawyer #6. Along similar lines, a sponsor-side lawyer explains, "They market to us and also market directly to our clients. . . . why they are particularly suited to play this role." Lawyer #7.
[181] Lawyer #8. Another sponsor-side lawyer explains, "Those partners at those [designated] firms do reach out to [name of sponsor] to make sure their relationships with [sponsor] are strong, which is freaking crazy because who are they really working for? They're in a tough spot because they have to maintain their credibility with their bank clients, and they also have to remain in [the good graces of sponsors]." Lawyer #18.
[182] Lawyer #19.
[183] Lawyer #1.
[184] Lawyer #1.
[185] Zhao, Chen, Cumming & Zhao, *supra* note 10, at 6.

misaligned incentives.[186] And those incentives may be even more misaligned when lenders' counsel appear to have closer relationships with sponsors, such as through the designation process.

* * *

There are many reasons the practice of lender designation persists even though it appears to tempt counsel with conflicts of interest. Sponsors and their counsel have the strongest incentives to favor the practice. Designated counsel also have financial incentives to favor the practice over the alternative of non-designation. Lenders, meanwhile, are known to complain about designation, but they have strong financial incentives to continue participating in bake-offs and engaging in leveraged lending. Designation evidently is an acceptable cost of doing business. A careful review of incentives also suggests that there are structural barriers to conflicts: designated counsel are paid by sponsors, but it is not obvious that they would want to prioritize sponsors' interests over those of lenders—with which law firms hired as designated counsel also do business—or that sponsors would want them to do so. In short, a complex of factors upholds the practice of designation, despite the grumbling that surrounds it.

IV. THEORETICAL & PRACTICAL IMPLICATIONS

Designation has a variety of important implications for issues as far-ranging as attorney ethics to the right level of judicial deference to contracts drafted in the shadow of significant potential conflicts.

This Part discusses some of those implications, beginning with the biggest: the potential ethical dilemma that arises when one party's counsel is appointed by a party with different interests. We also consider the impact of the practice on both the contractual terms that the parties agree and lenders' safety and soundness. We then examine how the practice erodes assumptions of good

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[186] But the results are confounded by several factors. For example, there was an overall decrease in the loan covenants over their sample period, 1995-2022, which is the same time period in which designation came into prominence. Our interviewees reported that designation slowly became the norm around the time of the 2008 Financial Crisis. *See infra* Part III. During that same time period, syndicated loans increasingly became "covenant light"—that is, they had fewer covenants that traditional loans. *See Leveraged Loans: Covenant-Lite Issuance Levels Off, Though Remains Strong*, S&P GLOB. MKT. INTEL. (Nov. 9, 2018), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/leveraged-loan-news/leveraged-loans-covenant-lite-issuance-levels-off-though-remains-strong (reporting that between 2015 and 2018, covenant light loans grew from 65% to 80% of the syndicated market). Moreover, number of covenants is not necessarily a good proxy for sponsor-friendliness, as covenants can be "loose" or "strict"—meaning that a deal with fewer but stricter covenants could be more lender-friendly than expected. *See* Hwang, McClane & Nili, *The Lost Promise of Private Ordering*, *supra* note 9.

process that underlie key arguments about the use of textualist interpretation in business contracts.

A. Attorney Ethics

Perhaps the most significant concern surrounding designation is an ethical one: Can lawyers selected by and paid for by a client's bargaining opponent be zealous, loyal counselors?

Designation clearly puts lenders' lawyers in an awkward position. On one hand, they want to drum up business, which comes from sponsors. But on the other hand, they are obligated to work for their lender clients.[187] While sponsors and lenders may often have similar incentives—for example, to agree on debt terms that help them win the M&A auction—their incentives are also often fundamentally misaligned.

In 2020, the New York State Bar Association Committee on Professional Ethics offered direct guidance on designation for lenders' counsel.[188] The committee assumed a highly simplified fact pattern in which lenders themselves negotiate a term sheet directly with the sponsor and designated counsel—who represents a single lender in bilateral negotiations with the borrower[189]—merely "prepare[s] the financing documents based on the terms negotiated by the [lender and sponsor]."[190] The Committee found the practice to be permissible.

But designated counsel are not mere scribes for lenders: they represent multiple lenders pitted against each other in the bake-off process, they see sponsors as the source of their business, and they can be punished by both lenders *and* sponsors if they do not negotiate within particular market norms. These factors greatly complicate the fact pattern considered by the committee—and we suspect that, had the committee considered these facts, their analysis may be somewhat different.[191]

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187 New York State Bar Association Committee on Professional Ethics, Opinion 1183, at para 9. As to these duties, see New York Rules of Professional Conduct Rule 1.1 (competence), 1.3 (diligence), 1.4 (communication), and 1.6 (confidentiality).

188 We consider New York here, because many of the lawyers handling these transactions are in New York.

189 The financial media has also mistakenly conceived of designated counsel as representing a single lender and overlooked the existence of bake-offs. *See, e.g.,* Sorkin, *supra* note 13.

190 *Id.* at para 4 ("According to the inquirer, no opportunity exists for the funders to use their designated counsel to negotiate the term sheet with the recipients. The role of the funders' designated counsel is thus to prepare the financing documents based on the terms negotiated by the funders (without benefit of counsel) and the recipients (with counsel).").

191 These factors help distinguish the practice from that in capital markets offerings under which corporate issuers of high volumes of securities designate counsel to represent the underwriting syndicates that evaluate their offerings. Among other things, there is nothing akin to a bake-off in underwriting. Instead, designated counsel represents all underwriters in the syndicate—whose

In the same guidance, the committee considered Rule 1.7(a), which deals with conflicts of interest. The committee found that under this rule, a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests."[192] While this rule bans the conflicted lawyer from representing its client, the committee relied on Rule 1.8(f) for an apparent exception to the ban, finding that a lawyer may accept the role of designated lenders' counsel paid for by the borrower "if the lawyer concludes the third party will not interfere with the lawyer's independent professional judgment and the lawyer obtains the informed consent confirmed in writing to the representation from the lawyer's client."[193]

While designation may appear to meet the Rule 1.8(f) exception to represent clients in conflicted circumstances, the committee's permissive conclusion overlooks some other important parts of the ethical rules. Specifically, Rule 1.8(f) is about accepting payment—but Rule 1.7 is about accepting the representation at all. And Rule 1.7(b) notes that lawyers may represent clients in conflicted situations if "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client."[194] This appears to be a harder condition to meet than the Rule 1.8(f) exception on which the committee relied, since the Rule 1.7(b) exception requires lawyers to have a reasonably grounded belief in their ability to represent clients competently.

It is worth noting that it is not clear that either requirement—the Rule 1.7 requirement *or* Rule 1.8(f) requirement—is necessarily satisfied in designation situations. Our interviewees report that borrowers do occasionally interfere with lenders' counsel. One interviewee, for instance, reported that

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interests are generally aligned—and there is no auction intended to elevate some clients over others. *See* William K. Sjostrom, Jr., *The Due Diligence Defense under Section 11 of the Securities Act of 1933*, 44 BRANDEIS L.J. 549, 564 (2006) (describing the practice). *See also* York State Bar Association, Committee on Professional Ethics, Ethics Opinion 818, Re: Conflicts of Interest; Persons Paying for Representation of Another; Designated Underwriters' Counsel, Nov. 28, 2007 (conditionally permitting the practice of issuer-designated underwriters' counsel).

192 *Id.* at para 15.

193 *Id.* at para 20. Rule 1.8(f) forbids a lawyer from accepting compensation from a non-client unless, among other things, "there is no interference with the lawyer's independent professional judgment" and the client gives informed consent. New York Rules of Professional Conduct, Rule 1.8(f).

194 Rule 1.7(b)(1). *See also* New York State Bar Association Committee on Professional Ethics, Opinion 1183, at para 17, citing N.Y. State 1154 (2018). Although the Committee referred to Rule 1.7(b) as authority for the exception to Rule 1.7(a), the two conditions it imposes—that the client gives informed consent and "there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship"—are drawn from Rule 1.8(f). The committee permits the designation if these two conditions are satisfied, without noting that Rule 1.7(b) imposes a distinct exception with a reasonableness requirement.

sponsor-side lawyers sometimes call the relationship partner at the lenders' counsel firm to complain about lawyers who, by being "chops-busters," are not "behaving like [they] should."[195]

Sponsors also regularly use subtler avenues of interference. For example, sponsors might put a law firm in the penalty box if they do not like what the counsel did on an earlier deal.[196] The threat of losing future business may compromise the lenders' counsel's ability to "reasonably believe[] that [they] will be able to provide competent and diligent representation to each affected client."[197]

For this reason, under ethical rules, some counsel may be obligated to decline sponsor-designation as lenders' counsel. For example, firms may not permissibly accept designation from sponsors that they believe have previously punished them for robustly representing their clients' interests, because lawyers designated by such a sponsor may not reasonably believe they can offer the representation required. Firms or lawyers that otherwise represent the sponsors that designate them or that rely heavily on designation by a handful of sponsors are at special risk of conflicts and, therefore, may need to decline designation.

The position of designated counsel is also more fraught than the Committee suggests because designated counsel represent lenders competing in one bake-off. Counsel might favor one lender's interests over another's. As other professional guidance puts it, different lenders "are adversely interested in the very matter in which they are seeking the lawyer's loyalty and counsel, and one client's success in that matter will necessarily result in failure for the other client in the same matter."[198]

To compound the issue, ethical rules demand that the lawyer disclose "the lawyer's business and personal interest in carrying out the representation."[199] But such disclosures do not appear to be the norm, much less considered obligatory.[200]

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[195] Lawyer #21 ("We often complain that at [name of designated firm], it very much depends on who you get. Some of the people are chops-busters…If we're dealing with a chops-buster [representing one of the trees], we'll call [name of lawyer at that firm] and say, "Will you talk to [name of lawyer]? Because he's not behaving like he should.").

[196] *See infra* Pt. III.F.iv.

[197] New York Rules of Professional Conduct, Rule 1.7.

[198] Association of the Bar of the City of New York Committee on Professional Ethics, Formal Opinion 2024-1: Ethical Issues Arising From the Representation of Two or More Bidders Competing for the Same Asset (2024), at 2. Otherwise put, "[A] conflict arises in this scenario because the lawyer cannot help one client without harming the other in the very same matter." *Id.* at 2 (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 c(i) (2000)).

[199] *See infra* Pt. III.F.iv. *See also* New York State Bar Association Committee on Professional Ethics, Opinion 1183, at para 16.

[200] Lawyer #9.

Lawyers we interviewed tell us that they "isolated" the trees in bake-offs. These appear to be somewhat similar to the formal ethical walls that lawyers often use to isolate conflicted legal teams within the same firm.[201] But lawyers do not necessarily see bake-offs as of apiece with the sorts of multiple-representation circumstances the committee contemplates. As one advisor explains, his firm does not regard acting as designated counsel in a bake-off as akin to representing multiple bidders with differing interests. Whether these informal measures satisfy ethical requirements is an open question.[202]

There are several other potential ethical issues worth mentioning, which we do not address here. One is the requirement that lenders limit their use of designated counsel—as both the New York Bar Association noted in its opinion and as our interviewees reported, it is quite common for sponsors to ask lenders to agree to parts of the agreement without counsel input.[203] Another is that sponsors' counsel sometimes play a role in designating lenders' counsel, which can give sponsors' counsel the power to make-or-break the careers of lenders' counsel.[204] Sponsors' counsel may allow personal interests to influence designation, for example, by steering designations away from law firms competing with them for sponsor-side business.[205] While designation of counsel can occur in other areas—such as for securities underwriters by corporate issuers in capital markets offerings—the sponsor–lender situation is one where

[201] Law firms may act in these situations through separate teams of lawyers representing each client if the firm obtains their clients' informed consent and if the relevant lawyers "reasonably believe[] that [they] . . . will be able to provide competent and diligent representation to each affected client." *Id.* at 3 (citing Rule 1.7(b)). Some conflicts may be non-waivable, although the firm might address these conflicts by "limit[ing] the scope of the representation for each client under Rule 1.2(c)," in order to "avoid[] direct adversity between its own teams." *Id.* at 6.

[202] At the same time, measures to protect client information and separate trees are considerably more protective than those prevalent in London, under which "the individual lawyer or lawyers advising the banks—whose interests may conflict—erect information barriers 'within their head,'" a practice known has having a "virtual tree" or "trees in the head." *See* Clark, *The Pendulum Swing*, *supra* note 1, at 48.

[203] In its guidance, the New York State Bar Association Committee on Professional Ethics noted this common requirement. *See* New York State Bar Association Committee on Professional Ethics, Opinion 1183.

[204] *See, e.g.,* Silas Brown, Will Louch & Laura Benitez, "The Powerful City Lawyer at the Center of a Private Equity Storm," *Bloomberg Law News*, Apr. 24, 2024 ("Being on the wrong side of them [sponsor's counsel] can result in law firms being frozen out of future deals.").

[205] According to a sponsor-side lawyer, "Why would I give business to a firm who is competing with me? Why would I want to designate [name of firm] if they are trying to take my sponsor business? … What I'm saying is that if you're picking [designating], you're picking [someone who's not competing with you]." Lawyer #20. Another sponsor-side lawyer explains, "[Name of firm] was someone I used to send work to, [but] they have more recently become a competitor. [They] have been targeting [name of sponsor client] for M&A work. The M&A is where the real money is made. That's the golden goose we try to protect." Lawyer #18.

unique circumstances lead to uniquely challenging questions of attorney conflicts.[206]

B. Bargaining Problems

Designation also creates impediments to bargaining, which in turn may undermine the optimality of deals struck between sponsors and lenders. Emerging scholarship critiques the long-held view in law and economics that sophisticated parties, given the right conditions, will reach optimal nonprice terms in their contracts, maximizing the joint surplus.[207] A corollary of this foundational view is that "other factors, such as bargaining power, the negotiation process, and negotiating skills, have no effect on the final non-price terms."[208]

Will Clayton, for example, notes that in limited partnership agreements (LPAs) negotiated between private equity sponsors and institutional investors, distorted bargaining incentives make limited partners "less likely to raise issues" and general partners "more likely to push back on issues" than they otherwise would be.[209] Elisabeth de Fontenay and Yaron Nili suggest that similar incentives arise when the same parties negotiate side-letter agreements alongside LPAs.[210] The parties sometimes subsidize each other's legal costs, meaning that participants have incentives to overuse lawyers, raising doubts about the optimality of the bargains reached.[211]

Here, designation has the potential to distort the bargain, too. Sponsors often expressly limit how much lenders can use designated counsel.[212] Moreover,

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[206] Although attorneys are sometimes conflicted in other situations, special facts make the designated counsel situation unique. For example, designated counsel in lending (1) are selected by their client's bargaining counterparty to represent the client against that counterparty and (2) are paid by the counterparty. Moreover, (3) designated counsel are selected to represent multiple competing clients against that counterparty (the bake-off) and (4) many of the parties involved in the deal are repeat players, so designated counsel are incentivized to play nice to win future designations from the same party. We are not aware of other settings in which all these factors arise. *See also supra* notes 60-62 and accompanying text.

[207] *See, e.g.,* Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003); Alan Schwartz, *How Much Irrationality Does the Market Permit?*, 37 J. LEGAL STUD. 131 (2008).

[208] Adam B. Badawi & Elisabeth de Fontenay, *Is There a First-Drafter Advantage in M&A?*, 107 CALIF. L. REV. 1119, 1127 (2019).

[209] William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703, 738 (2022).

[210] For more on distorted bargaining incentives in private equity, see Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 WASH. U. L. REV. 907 (2023); William Magnuson, *The Public Cost of Private Equity*, 102 MINN. L. REV. 1847 (2018); Jessica S. Jeffers & Anne M. Tucker, *Shadow Contracts*, 1 U. CHI. BUS. L. REV. 1 (2022). Jill E. Fisch, *Stealth Governance*, 99 WASH. U.L. REV. 913 (2022) (detailing the challenges posed by shareholder agreements in venture-funded start-ups when they affect corporate governance).

[211] De Fontenay & Nili, *supra* note 210, at 971-72.

[212] *See* Lawyer #9.

designated counsel that are perceived by sponsors as over-lawyering cannot expect to receive future designations. As a result, designated counsel may feel pressure to under-lawyer, leading to a bargain that skews in favor of the sponsor-borrower.[213]

There are further causes to doubt the optimality of loan terms between sponsors and lenders. Economic theory posits that sophisticated bargaining parties often negotiate the price term after the non-price terms, so that non-price divisions of joint surplus can be reflected in price.[214] But in the bake-off context, the non-price terms are often negotiated after the price term.[215] Only after counsel have been assigned—and therefore after key economic terms have been agreed—do the parties' respective counsel negotiate non-price terms.[216]

But in this second phase of the negotiation, sponsors' superior bargaining position casts a long shadow on the negotiation. A prominent law firm reported that "The terms of debt financing documents have for the last 20 years been on a steady march in the direction of flexibility for borrowers."[217] Financial media reports similar views, suggesting that sponsors' superior bargaining power has resulted in non-price loan terms that favor sponsors.[218] Banking regulators have also expressed concern about weakening loan terms offered to sponsors. Indeed, banking regulators reportedly linked loosening lender protections to the rise of designated lenders' counsel and investigated, although the results of these investigations do not appear to have been publicly disclosed.[219]

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[213] *See supra* Part III.

[214] MICHAEL KLAUSNER & GUHAN SUBRAMANIAN, DEALS: THE ECONOMIC STRUCTURE OF BUSINESS TRANSACTIONS 15-17 (2024) (describing this bargaining approach as "accepted in the negotiation literature").

[215] Albert Choi & George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665, 1690-91 (2012).

[216] But see Joshua D. Higbee, Matthew Jennejohn, Cree Jones & Eric Talley, *Fix the Price or Price the Fix? Resolving the Corporate Sequencing Puzzle in Corporate Acquisitions* (June 27, 2025 draft) manuscript on file with authors) (documenting the fact that price is often determined first in M&A deals) and Cathy Hwang, *Deal Momentum,* 65 UCLA L. Rev. 375, 380 (2018) (noting that preliminary agreements in M&A often document, first, the price of the deal).

[217] Wachtell, Lipton, Rosen & Katz, *Financing Year in Review: Opportunity Knocks*, Jan. 31, 2025.

[218] *See, e.g.,* notes 12-14 and accompanying text.

[219] *See* Halper & McKenna, *Designated Lender Counsel in Private Equity Loans*, *supra* note 18.

C. Erosion of Process

Designation appears to be at odds with some of corporate law's core principles of process and procedural propriety.[220] In a variety of substantive areas, corporate law has underscored the importance of using good process.

For example, in the fiduciary duty context, use of good process, including the use of fairness opinions, provides coverage for boards engaging in the M&A process.[221] The importance of process is also apparent in planning for management buyouts (MBOs).[222] Case law suggests that boards appoint special committees of independent directors to consider and approve MBOs.[223] Moreover, special committees ought to appoint independent legal and financial advisors to mitigate the potential influence of conflicted fiduciaries.[224]

Process is also important in other settings where fiduciary duties apply. In the seminal 1996 Delaware Chancery case *In re Caremark International*, the court clarified what has come to be known as the *Caremark* duty: a duty of directors to oversee the company by ensuring that there is a system in place for reporting material acts of the company, including compliance issues.

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220 *See* James An, *Substance and Process in Corporate Law*, 20 N.Y.U. J.L. & BUS. 187, 188 (2024) (equating "procedural propriety" with "whether the corporation's management used processes that are fair to stockholders to reach its decision").

221 Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). In general, courts give directors wide deference in corporate decision-making via a board standard of review. Boards that act via adequate process are afforded "business judgment review," which is "a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805 (1984). Business judgment rule protection means that courts generally do not second-guess the boards' decisions, even if the decisions end up leading to poor outcomes for the corporations. While fairness opinions have become almost ubiquitous in mergers and acquisitions, their judicial value lies in the supporting valuation analyses rather than in the opinion itself. *See* Andrew F. Tuch, *Fairness Opinions and SPAC Reform*, 100 WASH. U. L. REV. 1793 (2023) (explaining, by example, the value of supporting analyses in proxy statements).

222 *See* Tuch, *Managing Management Buyouts*, *supra* note 31, at 478 ("An MBO . . . puts participating managers on both the buy- and sell-sides of a transaction, a position that pits managers' self interest against their fiduciary duties of loyalty, creating conflicts of interest.")

223 Case law at least recognizes the cleansing effect of approval by a majority of disinterested directors or a special committee of such directors. *See, e.g.,* Salladay v. Lev, et al., No. CV 2019-0048-SG, 2020 WL 954032, at *23-26 (Del. Ch. Feb. 27, 2020); In re PNB Holdings Co. Stockholders Litig., No. CIV.A 28-N, 2006 WL 2403999 (2006); In re Wheelabrator Techs., Inc., S'holders Litig., 663 A.2d 1194 (Del. Ch. 1995). For an analysis of caselaw, see Tuch, *Managing Management Buyouts*, *supra* note 31, at 483-94; Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1308 (2016); Guhan Subramanian, *Deal Process Design in Management Buyouts*, 130 HARV. L. REV. 590 (2016).

224 *See, e.g.,* Scott V. Simpson & Katherine Brody, *The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest,"* 69 BUS. LAW. 1117, 1142 (2014).

The *Caremark* duty is itself a process-oriented one: directors are more protected from allegations of breaching their duties if they have, indeed, set up a system of reporting. And a series of recent *Caremark* cases, too, have underscored the message that process is critical.[225]

In each of these cases, courts have given more deference to management decisions when management makes decisions after engaging in the right process. One way to think about these decisions is that courts are less willing to intervene in the management/shareholder relationship when management has engaged in the right process.

These cases tee up two interesting questions for the practice of designation. First, designation does not directly affect the management/shareholder relationship, as *Caremark* and other cases do. As a predictive matter, would courts care about this practice if they knew about its oddities? And as a normative matter, should they? Second, even though designation does not affect the management/shareholder relationship, it does, as we have shown, set the stage for skewed incentives for lawyers and potentially suboptimal outcomes for lenders, with wide-ranging effects. Through what mechanism might there be change?

The second question helps to answer the first. As we have argued in the article, the practice already puts lenders' lawyers in ethically awkward positions. A relatively straightforward solution would be for the state bar associations' ethics committees to consider the propriety of such practice as a matter of attorney ethics.

However, barring that, investors of bank lenders and private equity sponsors should be concerned about the deals that lenders and sponsors are striking under this lopsided bargaining system. For lenders, the potential downsides are obvious: they could be striking sub-par bargains simply because they have acquiesced to designation. For sponsors, potential downsides are more subtle but still present: while sponsors are potentially getting better debt terms, they are also potentially missing out on the discipline that comes with striking bargains with engaged lenders who, for instance, monitor through covenants.

Courts, then, may enter the designation fray not through lawsuits related to the knock-on effects of designation on, for instance, the M&A process. Instead, courts might weigh in through contexts: attorney discipline, for instance, or shareholder suits from lenders' investors who feel that the lenders failed to obtain adequate counsel to negotiate good deals.

D. Text, Context, and the Interpretation of Business Contracts

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225 Marchand v. Barnhill, 212 A.3d 805 (Del. 2019); In re Boeing, 2021 WL 4059934 (2021).

Designation also calls into question the normative argument that courts should use a textualist approach to interpreting business contracts.

One of the longest-running debates in contract law is how courts should interpret contracts: via a textualist approach or a contextualist one.[226] Textualists argue for a plain-meaning reading of the contract as well as a strict parol evidence rule that does not allow admission of extrinsic evidence.[227] Contextualists advocate for the opposite: more extrinsic evidence of, say, course of dealing to better understand the parties' meaning.[228]

While this debate has many nuances, both textualists and contextualists generally agree that contextualism is more accurate.[229] Textualists, however, argue that contextualism takes more time and resources and opens the door for parties to engage in extended back-and-forth about what should and should not be considered.[230] The resulting lengthy litigation is not necessarily a good use of courts' limited resources.[231]

An interesting consequence of this trade-off between cost and accuracy is a difference in when courts and commentators prefer textualism over contextualism. As one of us writes in another article, "[t]he Uniform Commercial Code, which governs most everyday commercial transactions, takes a contextualist approach."[232] In contrast, scholars have argued that courts should use textualism when interpreting contracts between sophisticated parties, such as business parties.[233] Indeed, the courts where many sophisticated-party disputes are litigated—New York and Delaware—are textualist courts.

One way to think about why courts approach interpretation differently in these different types of disputes is to consider the bargains that underlie these disputes and whether they are entered into with sufficient consideration and process. Sophisticated-party transactions are likely to be process-oriented: the

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226 Cathy Hwang, *Collaborative Intent*, 108 VA. L. REV. 665, 699 (2022) (discussing the difference between textualist and contextualist approaches to contract interpretation).
227 Ronald J. Gilson, Charles Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 26 (2014) (putting forth the textualist argument that sophisticated parties have already "embed[ded] as much or as little of the contractual context as they wish in a written, integrated contract" and thus should have their contracts interpreted via a textualist approach).
228 *Id.* at 27.
229 Hwang, *supra* note 226, at 700.
230 Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 930 (2010) (noting that "although accurate judicial interpretations are desirable," "no interpretive theory can justify devoting infinite resources to achieve interpretive accuracy").
231 Hwang, *supra* note 226, at 700.
232 *Id.* at 700, citing U.C.C. § 1-303 (Am. L. Inst. & Unif. L. Comm'n 2017). The Restatement (Second) of Contracts also takes a contextualist approach. See Restatement (Second) of Contracts §§ 221–23 (Am. L. Inst. 1981).
233 *See* Gilson, Sabel & Scott, *Text and Context*, *supra* note 227, at 23, 26.

parties understand the bargain they are striking, are often advised by sophisticated counsel, and are less likely to be unduly influencing each other.[234] In contrast, business-to-consumer transactions are often struck between parties on uneven footing.[235]

The courts' split between textualism and contextualism suggests that courts may care about the bargaining process of the underlying transaction when considering how to interpret contracts.

Contract law scholars have argued convincingly that, at least for contracts between sophisticated business parties, textualism is the right approach because parties have already "embed[ded] as much or as little of the contractual context as they wish in a written, integrated contract."[236] Underlying this argument is an assumption that sophisticated business parties had a chance to negotiate for what they want in the contract; that "[i]f they had wanted courts to examine more context . . . , the sophisticated parties would have added that context ex ante."[237]

But as this article has shown, business parties may not have the opportunity to negotiate for what they want or to embed the provisions they want into the final contract. While the parties to a debt deal are sophisticated, and they are represented by sophisticated counsel, lenders' counsel appear to have divided loyalties. And while some lenders report that they either hire shadow counsel or have experienced in-house counsel to review designated counsel's work of their designated lenders' counsel, that practice appears far from the norm, and itself calls into question whether lenders believe that designated counsel are equipped to advance lenders' interests.

This article's findings also contribute to a robust literature on the irrationality of contract terms.[238] Marcel Kahan and Michael Klausner argued

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234 Cathy Hwang, *Faux Contracts*, 105 VA. L. REV. 1025, 1029 (2019) (noting that in business deals, parties are themselves sophisticated and are also well-advised by sophisticated counsel and financial advisors).

235 Thomas D. Haley, *Illusory Privacy*, 99 IND. L. REV. 75 (2022)

236 Gilson, Sabel & Scott, *Text and Context*, *supra* note 227.

237 Cathy Hwang, *Unbundled Bargains*, 164 U. PA. L. REV. 1403 (2016). Indeed, scholars have argued that sophisticated parties' choice not to include context—even when they have the ability to do so—is a considered one in light of litigation risk. Albert Choi & George Triantis, *Strategic Vagueness in Contract Design,* 119 YALE L.J. 848 (2010) (noting that material adverse change clauses are often vague even though litigation outcomes can be catastrophic, and that such vagueness is due to the fact that those provisions are rarely litigated); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 818–22 (2006) (discussing the differences between investment in contract design vs. investment in contract enforcement, and arguing that contracting parties can lower overall contracting costs by using vague contract terms ex ante to shift investment to ex post enforcement).

238 *See, e.g.,* Stephen J. Choi, Mitu Gulati & Robert E. Scott, THE HAZARDOUS WORLD OF CONTRACT: LAWYERS & THEIR LANDMINES (forthcoming Oxford University Press).

that suboptimal terms often enter into contracts due to agency costs, after which those terms proliferate due to path dependency, cognitive biases like status quo bias and conformity bias, and further agency costs of future drafters.[239] Robert Anderson and Jeffrey Manns have argued, too, that "editorial churning"—a desire by drafters to appear that they are adding value to contracts—have led longer and longer merger agreements, full of inefficient and standardized terms.[240] A series of articles by Stephen Choi, Mitu Gulati, and Robert Scott have documented the use of one meaningless term—the pari passu clause—in debt contracts in particular. As they note, the pari passu clause is widespread but purposeless and presents a puzzle that appears to be explained by norms, agency costs, norms, reputational enforcement, and cognitive biases.[241]

In much of the existing literature, the existence of these oddball terms is just that—an oddity worth exploring. Others have noted that agency costs play a role in the existence of these terms, but do not tell the whole story: indeed, the business parties' own risk aversion may lead to a desire not to eliminate common contract provisions, even when those provisions seem to lack real purpose.[242] But the practice of designation surfaces a more troubling possibility: that agency costs, now in the form of a lawyer's divided loyalties, are not just *one reason* for odd terms in contracts, but *the primary reason*.

This troubling possibility raises a normative question of how courts should interpret contract ambiguities that arise between sophisticated parties, given that even sophisticated parties may not be able to memorialize their intent fully in their contracts.

Sticking with textualist enforcement is one idea: Parties enter the transaction hoping to reap the efficiency benefits of designation, with the full knowledge that their designated counsel may be less than zealous. Perhaps courts should not, as textualists argue, be asked to pick up the slack caused by parties' own choices.

Another is to consider who is harmed by a strict textualist interpretation. Leveraged loans now often follows an "originate-to-distribute" model, in which banks quickly sell off their loans and retain relatively little risk for themselves. As one interviewee noted, for lenders, "There's risk but they just need to convince enough dumb buyers…" to sell the loan to after origination.[243]

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[239] Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U.L.Q. 347 (1996).
[240] Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 GEO. WASH. L. REV. 101 (2017).
[241] MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2012); Stephen J. Choi, Mitu Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate,* 67 DUKE L.J. (2017).
[242] Anderson & Manns, *supra* note 240.
[243] Lawyer #21.

Rationally, lenders may thus care relatively little about the risk of debt with suboptimal terms. But that debt is then sold to and held by others, such as pension funds. In that light, holding the parties to the terms of their contract through strict textualist terms might harm those who ultimately hold the debt, who may not have had a seat at the bargaining table at the outset.

It is easy to argue that all the sophisticated parties in this originate-to-distribute model—banks, institutional investors, and the like—are cognizant of the risks and pricing those risks into their investment decisions. But this kind of quick selling of financial instruments, with many in the food chain who have little skin in the game, was one of the drivers of the 2008 Financial Crisis.[244]

E. Financial Stability and Systemic Risk

There is also the possibility that suboptimal credit terms reached in bake-offs via this process might adversely affect the financial health of lenders and others. When banks, rather than direct lenders, arrange the LBO financing, poor lending standards may be more likely. To the extent that lenders syndicate their loans, they are not directly exposed to the risk posed by their loans. Instead, they quickly offload their loan exposure to others. This offloading of risk may weaken banks' resistance to designation and any weakening of loan terms that result. Poor lending standards may portend financial instability throughout markets—affecting lenders and others—given the mammoth size of the leveraged-lending sector. Weak lending standards also mean that borrowers are less likely to default on their debt, which has reduced the incidence of formal bankruptcies and fostered often controversial debt restructurings known as liability management exercises.[245]

Recognizing the risks to banks posed by leveraged lending, in 2013, the Office of the Comptroller of the Currency, the Federal Reserve, and the Federal Deposit Insurance Corporation promulgated leveraged lending guidelines.[246]

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[244] *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT xxiv (2011) ("From the speculators who flipped houses, . . . to the financial firms that created the mortgage-backed securities, collateralized debt obligations (CDOs), CDOs squared, and synthetic CDOs: no one in this pipeline of toxic mortgages had enough skin in the game. They all believed they could off-load their risks on a moment's notice to the next person in line. They were wrong.").

[245] *See* Sujeet Indap, *Corporate Money Troubles are Big Business for US Lawyers*, FIN. TIMES, Dec. 8, 2025 (linking the rise of liability management exercises over the past decade to covenant-lite loans); Quinn Emanuel, *Liability Management Exercises: What They Are and What They Mean for Market Participants*, Jan. 15, 2025, https://www.quinnemanuel.com/the-firm/publications/lead-article-liability-management-exercises-what-they-are-and-what-they-mean-for-market-participants/ ("Liability management transactions or exercises [] offer creative, albeit controversial, mechanisms for companies to raise debt capital where they may otherwise be facing a liquidity crunch and have no unencumbered assets to offer.").

[246] *See* DEPT. OF THE TREASURY, OFFICE OF THE COMPTROLLER OF THE CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS. & THE FED. DEPOSIT INS. CORP., INTERAGENCY GUIDANCE ON LEVERAGED LENDING ACTIVITIES (2013, 78 Fed. Reg. 17766 (March 22, 2013).

This interagency guidance from banking regulators was intended to prevent the build-up of risk in the banking system or broader financial system arising specifically from leveraged loans, understood to be loans made to private equity sponsors. As is well known, banks suffer from an asset-liability maturity mismatch since their liabilities—the deposits they accept—may be withdrawn on demand, while their assets, such as the loans they make, may be tied up for longer.[247] They are thus susceptible to bank runs or their equivalent.[248] The failure of banks can have pernicious knock-on effects, harming depositors and causing economy-wide harm. For this reason, large banks are considered too-big-to-fail and can expect government bailouts.[249] Suboptimal loan terms, whether the result of designation or some other activity, risk the financial health of institutions of paramount economic importance, warranting concern among lenders, policymakers, and indeed the public at large.

The problems with today's leveraged loan industry echo the problems that caused the 2008 Financial Crisis: massive lending with little lender oversight, quick sales of debt to downstream parties, and an overall system that feels as though there are no grown-ups at the wheel. The potential issues raised here are ripe for consideration by policymakers, as well as by scholars of law, economics, and finance.

Concerns about lenders' financial stability extend beyond banks to direct lenders.[250] Unlike banks, direct lenders are organized as private funds and are outside of the supervision of bank regulators.[251] Increasingly, this "shadow banking" industry has engaged in leveraged lending, intruding into the space formerly occupied by banks.[252] Because direct lenders commit to providing funding without intending to syndicate it, choosing instead to hold it to maturity,

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For a critique of this inter-agency regulation of leveraged loans, see Sung Eun (Summer) Kim, *Managing Regulatory Blindspots: A Case Study of Leveraged Loans*, 32 YALE J. REG. 89 (2015). On December 5, 2025, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation rescinded this 2013 guidance. *See* https://www.occ.treas.gov/news-issuances/news-releases/2025/nr-ia-2025-119.html.

247 *See* JOHN ARMOUR, DAN AWREY, PAUL DAVIES, LUCA ENRIQUES, JEFFREY N. GORDON, COLIN MAYER & JENNIFER PAYNE, PRINCIPLES OF FINANCIAL REGULATION 440–42 (2016).

248 As to the fragility of banks, see Douglas W. Diamond & Philip H. Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401 (1983).

249 *See* MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 318-23, 774-78 (3d ed, 2021).

250 *See* Eric Platt, "Moody's Warns of 'Systemic Risk' from Leveraged Lending Market," *Fin. Times*, Sept 28, 2023, https://www.ft.com/content/8371909f-1d3e-43ed-8b45-81f9b3e55473 ("Credit rating agency Moody's has warned of a "race to the bottom" between banks and private credit funds financing risky leveraged buyouts, a contest it believes will increase systemic risks across the US financial system.").

251 *See* Andrew F. Tuch, *The Remaking of Wall Street*, 7 HARV. BUS. L. REV., 315, 350 (2017) (observing that direct lenders, or credit funds, exist outside the "bank regulatory perimeter"). *See also* text accompanying *supra* notes 44-45.

252 *Id.* at 350.

direct lenders may be more careful in advancing loans.[253] However, if these lenders do wind up with suboptimal terms—due, perhaps, to less-than-zealous representation by designated counsel—they are vulnerable to failure. After all, direct lenders pay a price for the lack of supervision they enjoy: they are unable to count on the lender-of-last-resort function of the Federal Reserve.

An exploration of the full impact of designation on financial stability falls outside of the scope of this article, but policymakers across the globe have identified the risks leveraged lending poses to financial stability. Banks' originate-to-distribute model skews financial incentives, and light covenants increase risk for lenders.[254] The revelation of yet another incentive-skewing practice—that of designation—matters for law and policy.

F. Directions for Future Research

In this article, we only scratch the surface of designation's many potential implications. An understanding of the inner workings of this phenomenon opens many areas of future research, a few of which we flag here.

This article is a qualitative empirical study. A quantitative empirical study would be hard to undertake: borrowers and lenders do not disclose which loans involve designated counsel, making it difficult to separate designated loans from non-designated loans.

From interviews, we gather that designation is a phenomenon of the middle market and up. If regulators were to impose requirements for disclosure on designation, however, there may be fruitful quantitative studies to be done in this area. For example, it would be exciting to learn whether designation leads to better or worse deals for borrowers and lenders, whether certain counsel can generally broker better deals for their clients (whether sponsors or lenders), and the like.

For now, further studies might try to separate interviewees into groups based on the kinds of loans those lawyers usually handle or might interview deal principals, such as banks and private credit funds. These inquiries might shed light on lenders' capacity to temper designated counsel's otherwise questionable loyalties—for example, participating in bake-offs for competing sponsors in a single M&A auction, lenders could reward sponsors offering stronger legal representation with better terms.[255]

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[253] *See* Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L. J. 779 (2024).

[254] Hwang, Nili & McClane, *The Lost Promise of Private Ordering*, *supra* note 9.

[255] As to the potential of lenders to mitigate designated counsels' misaligned incentives, see Pt III.F.iii.

There is also the bigger empirical question: How might one test, empirically, the possibility that designation leads to odd terms in contracts?

Event studies are challenging because, during the same period that designation became the norm, macroeconomic factors, including an increase in the money supply and historically low interest rates,[256] also made lending much more competitive. Against that backdrop, borrowers gained negotiating power, and interview participants reported that borrowers used that power in part to designate their lenders' counsel.[257] Comparing contracts involving designated lenders with those that do not is also challenging. One finance paper has attempted to do this, but is unable to distinguish between loans with and without designated counsel.[258] Moreover, designation is widespread in large-cap and mid-cap private equity deals, but not in smaller transactions, meaning that any study that compares designated and non-designated loans may see results confounded by deal size. While this article's interview evidence provides a glimpse—and perhaps the only glimpse possible—into how designation affects contracts, perhaps later regulation will lead to more disclosure about designation, making an empirical study possible.

Theoretically, this topic also lends itself to a broader discussion of agency cost and agency problems. Lending is an area of business rife with advisors, each with their own incentives. Not only do lenders' lawyers have divided incentives between their clients and the sponsors who pay them, but others, too, have misaligned incentives.[259] We suspect, for instance, that individual bankers may commit to the debt on terms dictated by borrowers when bankers' compensation is tied to closing those deals, regardless of the resulting risk for the bank. The bankers and lawyers working on the core M&A deal, too, might have similar incentives. Several interviewees also reported that in just the last few years, many sponsors have hired new "capital markets directors" who play a role in the bake-off and counsel designation process.[260] Every member of this chorus brings their own incentives to the table, and the agency problems of this practice are well worth exploring.

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256 Andrew Dehan, *Mortgage Rate History: 1970s to 2025*, BANKRATE (Jan. 31, 2025).

257 *See* Part IV, *infra*.

258 *See supra* note 20 and accompanying text.

259 These include legal and financial advisors, as to which see *supra* note 49 and accompanying text.

260 As to this development, one lender-side lawyer explains:

> I actually did a survey of the top 100 AUM [assets under management] private equity firms. And all but three have a director of capital markets. [This is] someone who's in charge of the leveraged finance process … They will have a vested interest in who their lenders' counsel is in order to ensure that their LBO finance process goes smoothly because that's their job. … I would say 10 years ago, you saw those deal professionals only in the top [sponsors] who had a huge portfolio. [Lawyer #11].

CONCLUSION

This article explores the phenomenon of borrower-designated lenders' counsel: the widespread practice of private equity borrowers choosing and paying for their lenders' lawyers. Although industry commentators and regulators have flagged the practice as odd and conflicted, the practice is unexplored in the legal academic literature. Using practitioners' literature and original interviews with lawyers in the field, this article provides a nuanced description of the practice and reveals the rich web of factors that has led it to become the norm. Designation has widespread implications for both theory and practice, ranging from issues relating to ethical lawyering to those of contracting efficiency and interpretation and financial stability, which this article also explores.

Appendix A: Interviews & Methodology

This article is informed by interviews with attorneys who represent lenders and borrowers in debt transactions.

We used semi-structured interviews and asked a similar set of open-ended questions about the practice of borrower-designated lenders' counsel in M&A debt transactions. All interviews were conducted over Zoom, and we took notes in real time. We did not record interviews.

For brevity and anonymity, each interview participant is identified within the text of the article by a reference term, which is noted in the chart below.

To identify interview participants, we used *Chambers and Partners*, a respected publication available online that ranks law firms and individual lawyers by subject category.[261] Focusing on "Banking and Finance," both nationwide and in major financial centers, we identified firms and lawyers with potential expertise in leveraged finance. We reviewed web biographies of these lawyers and colleagues at their firms to identify those lawyers with extensive expertise in leveraged finance, whether on the sponsor- or lender-side. We also identified lawyers with relevant expertise from lawyer continuing education programs devoted to leveraged finance. We also used a snowball sampling technique, asking lawyers whom we interviewed for names of other recognized leaders in leveraged finance.

The chart below provides more information about individual interview participants.

Interview Participants

Reference Term	**Date interviewed**	**Position, city and focus of practice**
1.	7/15/24	Senior associate, New York
2.	8/6/24	Former General Counsel
3.	9/4/24	Senior associate, New York
4.	9/18/24	Partner, New York
5.	9/19/24	Partner, New York
6.	10/30/24	Partner, New York

261 *See Find the Top Lawyers and Law Firms in the Chambers USA Guide*, CHAMBERS AND PARTNERS, https://chambers.com/guide/usa?publicationTypeId=5 (last visited May 14, 2025) (describing the rankings, which Chambers bills as a guide to the best law firms and best lawyers in the USA).

7.	11/26/24	Partner, New York
8.	1/13/25	Partner, Chicago
9.	1/30/25	Partner, New York
10.	4/18/25	Partner, New York
11.	4/21/25	Partner, New York
12.	4/21/25	Partner, New York
13.	4/22/25	Partner, New York
14.	4/22/25	Partner, New York
15.	4/22/25	Partner, New York
16.	4/30/25	Partner, New York
17.	4/30/25	Partner, London
18.	5/1/25; 11/12/25	Partner, New York
19.	5/7/25	Partner, New York
20.	5/7/25	Partner, New York
21.	5/7/25, 10/31/25	Partner, New York
22.	5/8/25	Partner, New York

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