ABA National Legal Malpractice Conference LPL Panel - Hypothetical

Jefferson Brewing Co. ("JBC") is a privately held company. Three siblings, Warren, Joan and Ralph, own 30% apiece of JBC's shares. A private equity firm, the Milwaukee Fund, holds the remaining 10%, which it acquired in return for a cash investment in the company three years ago. JBC used the proceeds of that investment to expand the brewery for its Schotz Beer brand.

JBC's Board of Directors is made up of five persons: (1) Warren (who is the chair and corporate CEO), (2) Joan (who is COO), (3) Ralph (CFO), (4) Arthur (a representative appointed by Milwaukee Fund), and (5) Howard (a retired executive of the company).

Richard is a business lawyer at a substantial law firm. JBC is a significant long-time client of the firm, and Richard is the relationship partner. Richard is not a member of JBC's Board but, as the company's longtime counsel, he commonly attends Board meetings. Richard and his firm also have occasionally represented Warren, Joan and Ralph, individually, on estate planning and tax matters.

By all appearances, JBC is a successful business. It has over a thousand employees, and its financial statements show steady sales growth in recent years, particularly in the Schotz Beer brand, which has become the most popular in Wisconsin. JBC is little known outside of Wisconsin, however.

The Board is divided about how best to move forward with the business. Warren is anxious to take advantage of the company's recent success to grow the business to compete with major national and international brewers. He proposes to pursue an IPO and use the proceeds to build new Schotz Beer plants in other parts of the country to expand capacity. Milwaukee Fund is strongly in favor of Warren's plan; its business model is to invest in companies and sell them or take them public to realize a profit. Milwaukee Fund's investment agreement with JBC gives it the right to put back the shares to JBC at a modest profit if a sale or public offering does not occur within 10 years of their investment.

Joan and Ralph are not in favor of Warren's plan. They fear that a major expansion will erode the quality of the product, which is what sets JBC apart from its competition, and it will destroy the culture of the family business. They agree that JBC should expand, but they want to do it more gradually and use lending facilities rather than a public offering, with an eye to buying out Milwaukee at the end of the 10-year period.

Howard is on the fence. He shares Joan's and Ralph's concern that JBC should not change dramatically, but he is very close to Warren and has always dreamed of making Jefferson Brewing a household name nationwide.

Step One:

At the September 1 Board meeting, the members discuss their respective views about the company's future, which appear to be irreconcilable. The Board resolves to put the matter to a vote. Meanwhile, they collectively ask Richard, on behalf of the company, to give advice to them about what their rights and options are in light of this dispute.

Richard steps out of the meeting to call his firm's General Counsel, Marion. She tells Richard the situation is complicated and presents a risk to the firm. She and Richard decide to seek advice from the firm's outside counsel. That outside counsel is you. Marion and Richard are on the line. How do you advise the firm?

Step Two:

Richard obtained consent from all of the Board members to represent the company in this dispute, and he proceeded to give the requested advice about corporate governance. Richard did not advocate any particular outcome, but one of the things Richard told the Board members was that Joan and Ralph together owned a controlling (60%) interest in the Company and could take control of the Board. When Howard learned this, he decided to vote with Joan and Ralph to avoid greater disruption. On October 1, the IPO was voted down. Warren then resigned as CEO and chairman but kept his seat on the Board. Ralph became CEO and Joan became Chair of the Board.

On January 7, Richard receives a call from a prominent litigator in Milwaukee, Leonard, who says that he represents Warren and Milwaukee Fund. Leonard asks Richard to accept service on behalf of JBC of a shareholder derivative complaint filed by Warren and Milwaukee Fund against JBC, Joan, Ralph and Howard. The Complaint alleges that the defendants breached their fiduciary duties to the company and wasted corporate assets on improvident expenditures that the company could not afford.

Richard informs Joan, Ralph and Howard, each of whom wants Richard's firm to represent them in defense of the lawsuit. If Richard cannot represent the individuals for some reason, they would like him to represent the company.

Richard and Marion are on your line.

Step Three:

After a rancorous beginning to the lawsuit, the parties agree to a settlement shortly before discovery is scheduled to begin. Joan and Ralph agree to buy Warren's interest in JBC, with financing from a lending syndicate led by Milwaukee Fund. In return for arranging this financing, in addition to a right to repayment of the loan with interest, Milwaukee Fund will receive the right to acquire a majority interest in the Company from Joan and Ralph in three years if JBC is not sold for a profit or its shares offered to the public before that date.

All parties consent to Richard's firm representing JBC's, Joan's and Ralph's interests in structuring this transaction. Milwaukee Fund is represented by its separate counsel, a prominent corporate and securities firm, while Warren is represented by Leonard. Joan and Ralph tell

Richard that he is the only lawyer they trust to handle this matter, and Richard thinks everyone's interests will be best served if he accepts the engagement. He runs this by Marion, who agrees, but wants to get your opinion before making a final decision.

Step Four:

Richard accepts the engagement and the settlement and restructuring are consummated as described above. Richard's role is principally to draft and negotiate the transaction documents and assist the Company, Joan and Ralph in providing due diligence materials to the lenders.

One year later, Richard and Marion are shocked by a front-page story in the Milwaukee Journal Sentinel entitled "Fraud Allegations Brewing at Jefferson." It appears that the FBI has raided JBC's headquarters after a whistleblowing employee reported to the authorities that JBC has for years been inflating its sales figures in its financial statements and in its periodic reports to lenders. Joan and Ralph are arrested and charged with bank fraud and securities fraud. Warren is said to be cooperating with authorities; he is not believed to be complicit in the fraud. A spokesman for Milwaukee Fund announces that it has filed a court petition to place JBC in receivership.

Richard receives a panicked call from Howard. Howard says he knew nothing about any fraud, and he is not concerned for himself, but someone needs to represent the interests of JBC. Howard thinks Milwaukee Fund's goal is to liquidate the Company as quickly as possible and cut its losses. This will be terrible for JBC's thousand-plus employees and will put an end to an iconic company to which Howard has devoted his life. Howard begs Richard to do whatever he can to save the business.

How should Richard respond to Howard? What should Richard and his firm be concerned about in light of the new allegations of fraud?