COURT OF APPEALS
DECISION
DATED AND FILED

April 13, 1999

Marilyn L. Graves
Clerk, Court of Appeals
of Wisconsin

No. 97-3057

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT I

PAUL A. WEASLER,
YVONNE M. WEASLER-REARDON AND
ANTHONY V. WEASLER, II,

PLAINTIFFS-RESPONDENTS,

V.

WEASLER ENGINEERING, INC.,

DEFENDANT-APPELLANT.

APPEAL from an order of the circuit court for Milwaukee County: JOHN J. DiMOTTO, Judge. *Reversed in part and cause remanded with directions.*

Before Wedemeyer, P.J., Schudson and Myse, JJ.

PER CURIAM. Weasler Engineering, Inc. appeals from an order denying its motion to disqualify the law firm of Reinhart, Boerner, Van Deuren, Norris & Rieselbach, S.C. from representing former shareholders of Old Weasler

in an arbitration dispute. New Weasler claims that the trial court erred when it ruled that the Reinhart firm need not be disqualified. Because the substantial relationship test of Supreme Court Rule 20:1.9 governing disqualification was satisfied, we conclude that the trial court erred in denying New Weasler's motion and we reverse that portion of the order.[1]

I. BACKGROUND

This case arises from the sale of a family-owned business. Prior to August 11, 1995, Old Weasler Engineering was a Wisconsin corporation owned by the Weasler family. Paul A. Weasler, Yvonne M. Weasler-Reardon and Anthony V. Weasler, II, are the appointed representatives of the family for the purposes of this case.

From June 1993, through August 11, 1995, the Reinhart firm served as Old Weasler's regular corporate counsel. Old Weasler paid the Reinhart firm approximately $600,000 for legal advice and services. This work included business consultation, corporate structuring, strategic planning, employee benefits, labor, directors' and officers' duties, and corporate finance. The Reinhart firm also provided Old Weasler with significant tax planning advice, including tax and accounting treatment of legal and other expenses relating to the planned sale of the company. In addition, the Reinhart firm represented the company and its shareholders in the drafting, negotiation and closing of the stock purchase agreement.

[1] The order also grants the former shareholders' petition for arbitration. New Weasler does not challenge that portion of the order in this appeal and, therefore, we do not address it.

On August 11, 1995, pursuant to a stock purchase agreement, all of Old Weasler Engineering's shareholders sold their shares to Weasler Acquisition, Inc. On that same day, Weasler Acquisition, Inc. merged with Weasler Engineering and retained the name Weasler Engineering, Inc. (New Weasler). The surviving corporation has carried on the company's business virtually unchanged. As relevant to this appeal, the stock purchase agreement contained an "earn-out" provision. This provision, section 1.6 of the agreement, required New Weasler to make two earn-out payments to the selling shareholders. The amounts of the payments were tied to the company's net sales in fiscal years 1996 and 1997. The first earn-out was determined to be $246,936.36 and the second was to be $677,431.

The agreement also contained a tax warranty, wherein the selling shareholders warranted that New Weasler's unpaid taxes would not exceed a certain amount and that the company was to receive an income tax refund of $250,079. As it turned out, these tax warranties were inaccurate and the company actually owed substantial income taxes. The agreement further contained an indemnification provision, wherein the selling shareholders agreed to indemnify the merged corporation for any breaches of warranty. Finally, the last pertinent portion of the agreement involved an arbitration clause, which required the parties to arbitrate any disputes arising out of the earn-out provision.

In early 1997, New Weasler informed the selling shareholders that it would set off the $322,569 owed in taxes against the earn-out payment of $246,936.36. The selling shareholders objected to the action and, on August 27, 1997, the Reinhart firm filed a petition in Milwaukee County Circuit Court on the selling shareholders' behalf, to compel arbitration on the issue. In turn, New Weasler moved, pursuant to SCR 20:1.9 (Conflict of interest: former client), to

disqualify the Reinhart firm. The motion also requested an order prohibiting the Reinhart firm from disclosing any confidential information that it may have regarding the company.

On September 15, 1997, the trial court heard arguments, but declined to hold an evidentiary hearing. The trial court ruled that New Weasler was not a former client of the Reinhart firm for purposes of the sales agreement and concluded, as a result, that the Reinhart firm need not be disqualified. An order was entered to that effect on October 1, 1997. New Weasler moved for reconsideration, which was denied. Weasler petitioned this court for leave to appeal. On January 29, 1998, we granted the petition.

II. DISCUSSION

The issue in this case is whether the Reinhart firm's representation of Old Weasler, prior to the sale of the stock, creates a conflict of interest under SCR 20:1.9, which would require the Reinhart firm to be disqualified from representing former shareholders of the company in an arbitration dispute. We conclude that the substantial relationship test is satisfied under the circumstances presented here, thus requiring disqualification of the Reinhart firm.

"Motions to disqualify are reviewed under the misuse of discretion standard." ***Batchelor v. Batchelor***, 213 Wis.2d 251, 260, 570 N.W.2d 568, 572 (Ct. App. 1997). The trial court possesses broad discretion in determining whether disqualification is required in a particular case, and our review of that decision is limited accordingly. *See* ***id.*** If the record shows that discretion was in fact exercised and we can perceive a reasonable basis for the trial court's decision, we will not find an erroneous exercise of discretion. *See* ***id.***

The legal basis underlying New Weasler's disqualification motion is SCR 20:1.9 of the Rules of Professional Conduct for Attorneys. This section provides:

> **SCR 20:1.9 Conflict of interest: former client**
>
> A lawyer who has formerly represented a client in a matter shall not:
>
> (a) represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents in writing after consultation; or
>
> (b) use information relating to the representation to the disadvantage of the former client except as Rule 1.6 would permit with respect to a client or when the information has become generally known.

Wisconsin has devised a three-step inquiry, referred to as the substantial relationship test, to determine whether SCR 20:1.9 requires disqualification of a law firm. *See* ***Mathias v. Mathias***, 188 Wis.2d 280, 283, 525 N.W.2d 81, 84 (Ct. App. 1994); ***Berg v. Marine Trust Co., N.A.***, 141 Wis.2d 878, 885, 416 N.W.2d 643, 647 (Ct. App. 1987). The first step requires determining whether the party seeking to disqualify the firm is a former client. *See* ***Mathias***, 188 Wis.2d at 283, 525 N.W.2d at 83. The second step involves determining whether the general subject matter of the firm's work for the former client is substantially related to the subject matter of the current dispute. *See* ***id.*** The third step involves determining whether the interests of the firm's former client are materially adverse to the interests of the current client. *See* ***Tamara L.P. v. County of Dane***, 177 Wis.2d 770, 782, 503 N.W.2d 333, 337 (Ct. App. 1993). The determinations of the three steps are mixed questions of law and fact for the trial court. *See* ***Batchelor***, 213 Wis.2d at 261, 570 N.W.2d at 572.

Here, the trial court erroneously exercised its discretion in its application of the first step, i.e., whether New Weasler was a former client. The trial court initially observed that Reinhart did perform work for Old Weasler, but the court concluded that Old Weasler was not a former client "for purposes of [the stock] agreement and any disputes out of this agreement." The trial court further erred in its application of the second step, i.e, whether there was a substantial relationship in subject matter, concluding that because of the time line, there was no substantial relationship. The trial court found that any work Reinhart did for Old Weasler was "ancient history."

The trial court reached these erroneous conclusions based on Reinhart's assertions that it never really represented Old Weasler, but rather was long-time counsel for one of Old Weasler's shareholders, Paul Weasler. The billing documents in the record, however, contradict this assertion. The bills reflect that the company was the client billed for over $600,000 worth of services. The description of the services reveals that the services were for the company, rather than for an individual stockholder. Reinhart admits that the company paid its bills, but asserts that the company was simply paying the bills on Paul's behalf. This assertion, however, is untenable. In addition to an indication that Reinhart's account was with *Old Weasler* rather than with Paul, the bills do not contain any indication that the company was making the payments on Paul's behalf. In fact, the bill was directed to the attention of James N. Gennrich, Vice President of Finance at Old Weasler. Further, the only evidence in the record demonstrating that Paul, rather than the company, was actually Reinhart's former client is the affidavit of an attorney from Reinhart. Given this evidence, and in light of the law holding that any doubts about conflicts should be resolved in favor of disqualification, *see* ***Burkes v. Hales***, 165 Wis.2d 585, 596, 478 N.W.2d 37, 42

(Ct. App. 1991), we conclude that the company was a former client of the Reinhart firm. Reinhart appears to assert that even if it did represent the company prior to the merger, New Weasler was not a former client; we are not persuaded. As noted, New Weasler continued the same business operations of the pre-merged company. "Weasler Acquisition, Inc." was simply a shell company created to effectuate the stock sale. Under these circumstances, New Weasler is the equivalent of pre-merged Old Weasler for purposes of a conflicts analysis. *See* ***Tekni-Plex, Inc. v. Meyner and Landis***, 674 N.E.2d 663, 668 (N.Y. 1996).

We also conclude that the second part of the disqualification test is satisfied, i.e., the general subject matter of Reinhart's work for Old Weasler is substantially related to the subject matter of the current dispute. Because the law requires a law firm to avoid even the appearance of impropriety, this step is satisfied where the factual contexts of the former and current representations are "similar or related." ***Tamara L.P.***, 177 Wis.2d at 782, 503 N.W.2d at 337. The current dispute centers on the Reinhart firm's tax-planning advice to Old Weasler. The arbitration involves a dispute regarding whether New Weasler may offset taxes incurred contrary to the tax-planning advice against the earn-out payments required by the stock purchase agreement. The set-off rights, in turn, depend on the validity of New Weasler's claim for breach of tax warranty. The billing documents plainly reflect that Reinhart provided Old Weasler with tax planning advice and it is undisputed that the warranty at issue was drafted by the Reinhart firm. Under such circumstances, we conclude that the two representations are "similar or related." Thus, the second step of the disqualification test is satisfied.

Finally, we must address the third step of the disqualification analysis: whether the interests of the former client, Old Weasler, are materially adverse to the interests of the current client, the selling shareholders. We conclude

that this element is also satisfied. The selling shareholders have sued the company. The dispute involves whether the company can offset certain taxes from a payment owed to the shareholders. Under these circumstances, material adversity exists.

Based on the foregoing, we conclude that the trial court erroneously exercised its discretion in denying the motion to disqualify the Reinhart firm. Accordingly, we reverse that portion of the order and remand with directions to grant the motion.

By the Court.—Order reversed in part and cause remanded with directions.

This opinion will not be published. *See* RULE 809.23(1)(b)5, STATS.