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WEEKLY

Bankrupt company settles with fraudster's law firm

Settlement likely to help Ethanex get out of bankruptcy

By **SCOTT LAUCK**

scott.lauck@molawyersmedia.com

A defunct Kansas-based ethanol company reached a \$6.7 million settlement with the former firm of the lawyer who helped drive the company out of business.

The settlement with Richmond, Va.-based McGuireWoods will likely help Ethanex Energy Inc. get out of bankruptcy, said attorney John M. Edgar, of the Edgar Law Firm in Kansas City.

"I don't know whether it will pay everything there is to be paid, but there are no further assets left to liquidate," Edgar said.

Ethanex, of Basehor, Kan., hired McGuireWoods in 2006 to help it raise \$20 million in capital to build ethanol plants across the country. The company planned to execute a reverse merger, in which it would merge with a small company that was already publicly traded.

Prior to the merger, Ethanex would enter into a "private investment in public equity," or PIPE, transaction. Investors would get shares in the company at a discount, but those securities couldn't be sold until the company registered with the U.S. Securities and Exchange Commission.

Louis W. Zehil, a Florida-based McGuireWoods attorney working on the Ethanex deal, transferred 3 million Ethanex shares to two shell companies he controlled. He told the transferring agents that the shares didn't need the restrictive legends that prevented the stock from being freely traded. Zehil later sold them for an \$8.55 million profit.

Zehil was prosecuted in New York federal court for securities fraud related to the Ethanex deal

and six other companies, totaling \$17 million in illicit profits. He was sentenced in 2011 to three years in prison and ordered to repay restitution.

Ethanex declared bankruptcy in 2008. The bankruptcy trustee filed suit against McGuireWoods later that year, alleging that Zehil had used his position at the firm to carry out the fraudulent activities, including using firm letterhead to order the unrestricted stock to be issued to his shell companies. Ethanex had paid the firm more than \$350,000 in fees and expenses.

Edgar said Zehil's fraud scared off Ethanex's investors.

"If you have a choice between investing in a company where there's been a scandal and a fraud like this and nobody even quite understands yet what's happened, or a company that's clean, you're going to go invest with the com-

pany that's clean," he said.

McGuireWoods fired Zehil in 2007 after it discovered his conduct. In a response to the lawsuit, the firm said it promptly told Ethanex what had happened, and that Zehil's illicit securities trading "was conducted for his personal benefit and in no way for the benefit of McGuireWoods, was beyond the time and space limits of his role as a lawyer, was outside the scope of his employment, and was without actual or apparent authority and outside the ordinary course of McGuireWoods's business."

The firm added that Ethanex had faced numerous other financial difficulties before it went under, pointing out that despite spending millions of dollars, the company never broke ground on a single ethanol plant.

The settlement was filed

with the Kansas bankruptcy court on March 25. U.S. District Judge Carlos Murguia formally dismissed the suit against McGuireWoods on April 22.

According to records filed in the bankruptcy proceeding, the settlement included \$2.4 million in attorneys' fees and reimbursement of about \$23,000 in litigation expenses for the Edgar Law Firm.

An attorney for McGuireWoods, Larry Ward, of Polsinelli's Kansas City office, did not return a call seeking comment. Michael J. Kulstad, a spokesman for McGuireWoods, did not respond to a request for comment.

The case is *Eric C. Rajala, as Bankruptcy Trustee for Ethanex Energy Inc. v. McGuireWoods LLP*, 2:08-cv-2638. The bankruptcy case is *In Re: Ethanex Energy Inc.*, 08-20645. **MO**

\$6.7 Million settlement

LEGAL MALPRACTICE FRAUD

- **Venue:** U.S. District Court for the District of Kansas
- **Case Number/Date:** 2:08-cv-2638/April 22, 2013
- **Judge:** Carlos Murguia
- **Plaintiff's Experts:** Mark Beemer, Pekin, Ill. (ethanol industry); Geoffrey C. Hazard Jr., San Francisco, Calif. (legal ethics); Mitchell S. Hoffman, Denver, Colo. (damages); Robert Parrino, Austin, Texas (finance); Praveen V. Vadlani, Manhattan, Kan. (ethanol processing)
- **Defendant's Experts:** Bruce A. Babcock, Ames, Iowa (economics); Charles W. Chigas, Cold Spring, N.Y. (Finance); Willard J. Duensing, Jefferson, Wis. (corn milling); Keir D. Gumbs, Washington, D.C. (securities law); Thomas D. Morgan, Washington, D.C. (antitrust law); Richard A. Rodgers, San Francisco, Calif. (Finance); Keith R. Ugone, Dallas, Texas (damages)
- **Insurance Carrier:** Lloyd's of London
- **Caption:** Eric C. Rajala, as Bankruptcy Trustee for Ethanex Energy Inc. v. McGuireWoods LLP
- **Plaintiff's Attorneys:** John M. Edgar, David W. Edgar, Boyce N. Richardson and Matthew J. Limoli, Edgar Law Firm, Kansas City
- **Defendant's Attorneys:** R. Lawrence Ward, James M. Humphrey and Miriam E. Bailey, Polsinelli, Kansas City