



Alerts

Lawyers Beware: California Court Applies Multi-Factor Test to Determine if LLC Attorney Inadvertently Formed an "Implied" Attorney-Client Relationship with Individual LLC Members

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Sprengel v. Zbylut, California Second Appellate District Case No. B282129 (September 10, 2019)

Brief Summary

A California appellate court recently extended the application of a longstanding "totality of the circumstances" legal analysis of whether a partnership's attorney has formed an "implied" attorney-client relationship with an individual partner. Specifically, the court applied the test to the question of whether a limited liability company's attorney had formed an "implied" attorney-client relationship with an individual member.

Over two decades ago, *Responsible Citizens v. Superior Court*, 16 Cal.App.4th 1717 (1993) and *Johnson v. Superior Court*, 38 Cal.App.4th 463 (1995) articulated a multi-factor test for courts to assess whether there is sufficient evidence to support a finding that a partnership's attorney formed an implied attorney-client relationship with individual partners. In the recently published *Sprengel* case, the Second Appellate District applied the same test in a legal malpractice action brought by one of two limited liability company members against the company's attorneys, after the member was forced to defend against the company pertaining to her personal interest in a disputed copyright. The appellate court affirmed summary judgment in favor of the defendant attorneys, based on the "totality of the circumstances," including primarily that the adversarial nature of the relationship between the company's attorneys and the jilted member was clear from the time the attorneys were retained.

Complete Summary

In 2008, Jean Sprengel and Lanette Mohr formed a limited liability company (the "LLC"), each with a 50% share. While neither member held "the authority to bind the Company without the consent and/or approval of the other," Mohr was named as the manager. In 2010, their relationship deteriorated, because of a management dispute involving Sprengel's concern that Mohr was misusing corporate funds and infringing on Sprengel's purported copyright. Mohr retained

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Gregory Zbylut and Vincent Cox to provide tax and IP legal services for the LLC. Thereafter, Cox wrote to Sprengel's personal attorney, asserting that the LLC did not infringe on her rights. Cox also assisted Mohr in preparing a copyright registration that listed both members and the LLC as claimants. When Sprengel learned Mohr had retained Zbylut, she withdrew a substantial sum from the company's bank account and transferred the funds into her personal attorney's trust account. Sprengel then filed a state court action to involuntarily dissolve the LLC and a separate federal action against Mohr for copyright infringement. Mohr retained Cox to represent the LLC to seek intellectual property rights and to sue Sprengel for wrongfully taking the LLC's funds.

For background, the California appellate court first addressed two discrete legal issues that had been decided in the separate federal copyright infringement action. First, after Mohr requested the LLC be joined as a necessary party, Sprengel named the LLC as a nominal defendant and retained Thomas Foley to represent the LLC. The district court granted Mohr's motion to disqualify Foley, "concluding that because Sprengel and Mohr were both 50 percent owners of the company, conflict of interest principles precluded either of them from unilaterally selecting corporate counsel." Ultimately, the district court found that the LLC did not need counsel because it had no discernible "interest independent of its owners." Second, the California appellate court briefly mentioned the district court's discovery ruling which held Mohr could not assert the attorney-client privilege against Sprengel with respect to the LLC's communications with Zbylut and Cox, because each member held equal control over management.

After the federal action concluded, Sprengel filed a legal malpractice action against Zbylut and Cox, alleging the attorneys provided services to the LLC for the benefit of Mohr and to the prejudice of Sprengel. In addition to alleging the attorney defendants failed to communicate with her and failed to obtain conflict of interest waivers, Sprengel sought disgorgement of fees because she had not consented to their retention. The trial court granted summary judgment, finding that Sprengel lacked standing and failed to establish that she and the defendants had an attorney-client relationship. The appellate court affirmed.

Sprengel did not challenge the trial court's determination that she lacked standing to prosecute a direct action for disgorgement of fees, conceding that claim is derivative and not personal. Rather, Sprengel contended that she had an "implied" attorney-client relationship with the attorneys because of her co-ownership of the LLC. Sprengel argued the attorneys breached their duty of loyalty to Sprengel because the legal services they performed "forced her to incur expenses to defend her personal copyrights."

The appellate court first addressed the general rule that a company's attorney does not owe a duty to shareholders. See *La Jolla Cove Motel & Hotel Apartments, Inc. v. Superior Court*, 121 Cal.App.4th 773, 784 (2004); *Skarbrevik v. Cohen, England & Whitfield*, 231 Cal.App.3d 692, 703-704 (1991) ("corporate counsel's direct duty is to the client corporation, not to the shareholders individually, even though the legal advice rendered to the corporation may affect the shareholders"); see also Cal. Rules of Prof. Conduct, Rule 1.13. The appellate court then acknowledged that an "implied" attorney-client relationship may be created in a partnership context based on the "totality of the circumstances." See *Responsible Citizens v. Superior Court* 16 Cal.App.4th 1717, 1732 (1993) (partnership's attorney may, through conduct, form an "implied" attorney-client relationship with individual partners). While *Responsible Citizens* did not involve an LLC, the appellate court noted that "the decision does not contain any language limiting its holding to partnerships, and substantial portions of the decision analyze corporations and partnerships interchangeably." *Id.* at 1726-1729.

Then, the appellate court applied the factors set forth in *Responsible Citizens* and its progeny. While the LLC's two-member composition weighed in favor of an implied attorney-client relationship, several other factors "clearly undercut the implication" of it. The appellate court was not swayed by Sprengel's claim that the attorney's role in assisting Mohr and the LLC in claiming ownership over copyrights was a breach of the duty of loyalty with respect to Sprengel's purported personally-held rights: "Sprengel has cited no authority suggesting that, standing alone, an attorney's representation of a closely-held corporation gives rise to professional duties to the individual shareholders with respect to personally-held rights that are both separate from, and adverse to, the corporation itself."

Assessing the "totality of the circumstances," the appellate court found: "Sprengel never believed, or had any reason to believe, defendants were acting to protect her personal interests, or had impliedly agreed to avoid representations that were adverse to those interests." For example, Cox's letter to Sprengel's personal attorney challenging her copyright claim "made it clear" that his representation was adverse to Sprengel. Moreover, Sprengel's transfer of company assets and



retention of a separate attorney after learning that Mohr had retained defendants were actions inconsistent with Sprengel contending that the defendants represented her. The appellate court affirmed summary judgment, concluding that the "adversarial nature of their relationship was clear" when Mohr retained the defendants.

Significance of the Case

This decision should serve as a reminder for attorneys to stay in their lane when representing corporate entities and to avoid inadvertently representing individual partners or members. If an individual member claims the attorney represented the member personally, California courts will "assess whether the parties conducted themselves in a way that would reasonably cause a shareholder to believe the attorney would protect the shareholder's individual interests." The court provided the following non-exhaustive list of factors to consider:

1. The size of the partnership;
2. The nature and scope of the attorney's engagement;
3. The kind and extent of contacts between the attorneys and the individual partners;
4. The attorney's access to financial information relating to the individual partner's interests; and
5. "[P]rimary attention should be given to whether the totality of the circumstances, including the parties' conduct, implies an agreement by the partnership attorney not to accept other representations adverse to the individual partner's personal interests." *Responsible Citizens, supra*, 16 Cal.App.4th at p. 1733.

For more information contact Terrence P. McAvoy or Joanna L. Storey