



# California Corporate & Securities Law

## **Court of Appeal Holds That Employee Indemnification Statute Does Not Reach “First Party” Lawsuits**

By Keith Paul Bishop on October 13, 2011

If you ask a corporate law attorney about indemnification of officers and other corporate agents, she will likely steer you to Corporations Code § 317. Ask an employment law attorney the same question, and she will likely refer you to Labor Code § 2802. In *Nicholas Laboratories, LLC v. Chen*, 4th Dist. Ct. Appeal Case No. G044105 (Oct. 12, 2011), both statutes were at issue.

### **Labor Code § 2802**

Labor Code § 2802(a) codifies California’s strong public policy favoring indemnification (and defense) of employees by their employers:

An employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.

In the dog days of the summer of 2000, Senator Liz Figueroa authored legislation to clarify that employees are entitled to reasonable attorney fees and costs incurred in enforcing this right. Stats. 2000, ch. 990.[\[1\]](#)

### **What Happens When An Employer Sues The Employee?**

In *Nicholas Laboratories*, a former employee argued that Labor Code § 2802 obligates an employer to indemnify an employee not only for expenditures and losses arising out of third party lawsuits, but also for an employee’s attorney fees when the employer unsuccessfully sues the employee based on action of the employee during the course of employment. Noting a lack of clear authority, the Court of Appeal concluded that the legislature in drafting the statute did not intend to depart from the usual meaning of the word “indemnify” to address “first party” disputes between employers and employees.

The court did not say whether this interpretation applies to derivative lawsuits, particularly when the suits are dismissed for failure to plead adequately demand or demand futility.

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## Status Matters

The Court of Appeal also rejected the plaintiff's claim to indemnification under Corporations Code § 317. If you've been reading carefully so far, you may be able to guess why. The court found that the statute applies to corporations and not to limited liability companies.

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[1] The bill, SB 1305, was yet another "gut and amend". Until its amendment at the eleventh hour, the bill concerned the deadline for hearings and a report from a legislative review committee. For more on "GANDA" bills, see this [post](#).

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