Sue An Employee, But Pay For Attorneys' Fees?

Insights
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Court weighs in on complicated indemnity statutes.
Employers defending wage claims in proceedings before the California Labor Commissioner are not permitted to file complaints or cross-claims against their employees, but that's not the case when a complaint is filed in civil court. Employers faced with complaints from employees seeking unpaid wages may have grounds to file cross-complaints based upon employee misconduct, or they may file a direct lawsuit. An employer may be eager to file such complaints to help "settle the score" where the suing employee committed serious wrongs against the company.

The Indemnity Issue
But employers have a number of reasons to exercise caution with regard to such complaints. One chief concern involves indemnity, i.e., to what extent you could be required to indemnify the employee the costs incurred in defending the complaint or cross-complaint where the alleged actions of the employee arose during the course and scope of the employee's employment.

Part of the Labor Code provides that "[a]n 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. (Emphasis added)."

And the California Corporations Code provides in part, "To the extent that *an agent* of a corporation has been successful on the merits in defense of any proceeding referred to in subdivision (b) or (c) or in defense of any claim, issue, or matter therein, the agent shall be indemnified against expenses actually and reasonably incurred by the agent in connection therewith. (Emphasis added)."

The issue of indemnity recently was addressed by a California appeals court, which determined that neither the Labor Code section nor the Corporations Code section quoted above, authorize a court to award attorneys' fees to a prevailing employee defendant in a civil suit prosecuted by the employer when the employer is a limited liability company. *Nicholas Laboratories, LLC v. Chen.*

Resolving The Two Statutes

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In *Nicholas Labs*, a limited liability company sued one of its employees for breach of contract, breach of the implied covenant of good faith and fair dealing, conversion, negligence, money had and received, unjust enrichment, and constructive trust. The employee filed a cross-complaint for an award of the attorneys' fees he incurred in defending against the employer's complaint. In his cross-complaint, the employee asserted that he was entitled to attorneys' fees pursuant to the Labor Code and Corporations Code sections, and the terms of his employment agreement.

On the eve of trial, the employer dismissed its complaint without prejudice in exchange for the employee agreeing to have the court decide his cross-complaint upon written evidentiary submissions.

After reviewing the matter, the trial court rejected each of the employee's rationales for attorneys' fees. With regard to the Labor Code, the trial court held that the statute does not apply to lawsuits filed by an employer against an employee. The trial court further held that a judicial determination on the merits was a necessary requirement for an award of attorneys' fees under the Corporations Code – which a dismissal without prejudice failed to satisfy.

On appeal, the Fourth District Court of Appeal concurred with the trial court's decision. In affirming the trial court's decision, the Fourth District Court of Appeal determined that the California Legislature intended the term "indemnify" in the Labor Code to pertain only to third party lawsuits against the employee.

On the question of the Corporations Code, the Court of Appeal did not reach the trial court's decision that the statutory provision required a judicial determination on the merits. Rather, the appellate court held that this law did not apply to limited liability companies, ruling that the term "corporation" within did not include limited liability companies, and that indemnity matters concerning limited liability companies were governed exclusively by the Beverly-Killea Limited Liability Company Act, a separate statute.

What Impact?

Of course, the favorable ruling in *Nicholas Labs* does not rule out all impediments to an employer filing a complaint or cross-complaint against an employee. Sometimes these counter-actions can be viewed as spurious or retaliatory, giving rise to potential actions for malicious prosecution or relief under California's anti-SLAPP statute, which provides for a special motion to strike a complaint where the complaint arises from activity exercising the rights of petition and free speech. The statute was first enacted in 1992.

An Anti-SLAPP motion will be denied if the opposing party, here the employer, demonstrates the probability that it will prevail on the claim. This requires a showing that the complaint is both legally sufficient and that sufficient evidentiary facts exist to sustain a favorable judgment if the evidence is credited. If a court grants the motion, it will dismiss the complaint (or cross-complaint) and award the moving party its attorneys' fees and court costs.

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The Bottom Line

Despite these potential challenges, employers should still consider all legitimate options when defending a wage and hour lawsuit. Sometimes the existence of cross-claims can motivate employees to significantly discount their claims during mediation or informal settlement discussions.

If you are forced to defend a lawsuit filed by an employee against whom you have legitimate grievances, you should think carefully about whether to bring a cross-complaint or seek other relief. After considering all of the options, you will be in the best position to make sound strategy choices in defending your company during litigation.

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