

## RESOLUTION 03-07-2012

### DIGEST

#### Mandatory Indemnification of Employees of Limited Liability Companies:

Adds Corporations Code section 17159 to provide the same indemnity rights to employees and agents of limited liability companies that are provided to employees and agents of corporations.

### RESOLUTIONS COMMITTEE RECOMMENDATION DISAPPROVE

#### History:

No prior resolutions found.

#### Reasons:

This resolution adds Corporations Code section 17159 to provide the same indemnity rights to employees and agents of limited liability companies that are provided to employees and agents of corporations. This resolution should be disapproved because a limited liability company is designed to be a separate and distinct type of business entity that does not have the same obligations as a corporation, and is unnecessary because Corporations Code section 17155 already authorizes the articles of organization or operating agreement to provide for indemnification of any agent of the LLC. Specifically, if an LLC chooses, it may provide in its articles of organization or operating agreement that any agent of the LLC, including any manager, member, officer, employee, may be indemnified against any judgments, settlements, penalties, fines or expenses of any kind incurred as a result of acting in that capacity. Adding a new Section 17159 is not only unnecessary, but it is inconsistent with the existing Section 17155 that already authorizes indemnification, and further would change the dynamic of what an LLC is as an entity.

Finally, true employees of an LLC already have the indemnification rights provided by Labor Code section 2802. The title of this resolution is misleading in its reference to providing “employees” with indemnification rights. It is also misleading in stating that the indemnification it would provide would be “mandatory.” Neither Corporations Code section 317 nor this resolution, which parrots its wording, are at all clear as to anything mandatory, and deal primarily with that which the subject entity has the power and the discretion to do.

### TEXT OF RESOLUTION

RESOLVED, that the Conference of California Bar Associations recommends that legislation be sponsored to add Corporations Code section 17159 to read as follows:

- 1 § 17159
- 2 (a) For the purposes of this section, “agent” means any person who is or was a member,
- 3 manager, officer, employee or other agent of the limited liability company, or is or was serving
- 4 at the request of the corporation as a director, officer, employee or agent of another foreign or
- 5 domestic corporation, partnership, joint venture, trust or other enterprise, or was a director,
- 6 officer, employee or agent of a foreign or domestic corporation which was a predecessor

7 corporation of the limited liability company or of another enterprise at the request of such  
8 predecessor corporation; “proceeding” means any threatened, pending or completed action or  
9 proceeding, whether civil, criminal, administrative or investigative; and “expenses” includes  
10 without limitation attorneys' fees and any expenses of establishing a right to indemnification  
11 under subdivision (d) or paragraph (4) of subdivision (e).

12 (b) A limited liability company shall have power to indemnify any person who was or is a  
13 party or is threatened to be made a party to any proceeding (other than an action by or in the right  
14 of the limited liability company to procure a judgment in its favor) by reason of the fact that the  
15 person is or was an agent of the limited liability company, against expenses, judgments, fines,  
16 settlements, and other amounts actually and reasonably incurred in connection with the  
17 proceeding if that person acted in good faith and in a manner the person reasonably believed to  
18 be in the best interests of the limited liability company and, in the case of a criminal proceeding,  
19 had no reasonable cause to believe the conduct of the person was unlawful. The termination of  
20 any proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or  
21 its equivalent shall not, of itself, create a presumption that the person did not act in good faith  
22 and in a manner which the person reasonably believed to be in the best interests of the limited  
23 liability company or that the person had reasonable cause to believe that the person's conduct  
24 was unlawful.

25 (c) A limited liability company shall have power to indemnify any person who was or is a  
26 party or is threatened to be made a party to any threatened, pending, or completed action by or in  
27 the right of the limited liability company to procure a judgment in its favor by reason of the fact  
28 that the person is or was an agent of the limited liability company, against expenses actually and  
29 reasonably incurred by that person in connection with the defense or settlement of the action if  
30 the person acted in good faith, in a manner the person believed to be in the best interests of the  
31 limited liability company and its members. No indemnification shall be made under this  
32 subdivision for any of the following:

33 (1) In respect of any claim, issue or matter as to which the person shall have been  
34 adjudged to be liable to the limited liability company in the performance of that person's duty to  
35 the limited liability company and its members, unless and only to the extent that the court in  
36 which the proceeding is or was pending shall determine upon application that, in view of all the  
37 circumstances of the case, the person is fairly and reasonably entitled to indemnity for expenses  
38 and then only to the extent that the court shall determine.

39 (2) Of amounts paid in settling or otherwise disposing of a pending action without court  
40 approval.

41 (3) Of expenses incurred in defending a pending action which is settled or otherwise  
42 disposed of without court approval.

43 (d) To the extent that an agent of a limited liability company has been successful on the  
44 merits in defense of any proceeding referred to in subdivision (b) or (c) or in defense of any  
45 claim, issue, or matter therein, the agent shall be indemnified against expenses actually and  
46 reasonably incurred by the agent in connection therewith.

47 (e) Except as provided in subdivision (d), any indemnification under this section shall be  
48 made by the limited liability company only if authorized in the specific case, upon a  
49 determination that indemnification of the agent is proper in the circumstances because the agent  
50 has met the applicable standard of conduct set forth in subdivision (b) or (c), by any of the  
51 following:

52 (1) A majority vote of a quorum, consistent with the provisions of Sections 17103-17104

53 of this Chapter, consisting of members who are not parties to such proceeding.

54 (2) If such a quorum of members is not obtainable, by independent legal counsel in a  
55 written opinion.

56 (3) The court in which the proceeding is or was pending upon application made by the  
57 limited liability company or the agent or the attorney or other person rendering services in  
58 connection with the defense, whether or not the application by the agent, attorney or other person  
59 is opposed by the limited liability company.

60 (f) Expenses incurred in defending any proceeding may be advanced by the limited  
61 liability company prior to the final disposition of the proceeding upon receipt of an undertaking  
62 by or on behalf of the agent to repay that amount if it shall be determined ultimately that the  
63 agent is not entitled to be indemnified as authorized in this section.

64 (g) The indemnification authorized by this section shall not be deemed exclusive of any  
65 additional rights to indemnification for breach of duty to the limited liability company and its  
66 members while acting in the capacity of a manager or officer of the limited liability company to  
67 the extent the additional rights to indemnification are authorized in an article provision adopted  
68 pursuant to this Chapter. The indemnification provided by this section for acts, omissions, or  
69 transactions while acting in the capacity of, or while serving as, a manager or officer of the  
70 limited liability company but not involving breach of duty to the limited liability company and  
71 its members shall not be deemed exclusive of any other rights to which those seeking  
72 indemnification may be entitled under any bylaw, agreement, vote of members, or otherwise, to  
73 the extent the additional rights to indemnification are authorized in the articles of organization.  
74 An article provision authorizing indemnification “in excess of that otherwise permitted by  
75 Section 17159” or “to the fullest extent permissible under California law” or the substantial  
76 equivalent thereof shall be construed to be both a provision for additional indemnification for  
77 breach of duty to the limited liability company and its members. The rights to indemnity  
78 hereunder shall continue as to a person who has ceased to be a manager, member, officer,  
79 employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of the  
80 person. Nothing contained in this section shall affect any right to indemnification to which  
81 persons other than the managers, members, officers, or employees may be entitled by contract or  
82 otherwise.

83 (h) No indemnification or advance shall be made under this section, except as provided in  
84 subdivision (d) or paragraph (4) of subdivision (e), in any circumstance where it appears:

85 (1) That it would be inconsistent with a provision of the articles, bylaws, a resolution of  
86 the members, or an agreement in effect at the time of the accrual of the alleged cause of action  
87 asserted in the proceeding in which the expenses were incurred or other amounts were paid,  
88 which prohibits or otherwise limits indemnification.

89 (2) That it would be inconsistent with any condition expressly imposed by a court in  
90 approving a settlement.

91 (i) A limited liability company shall have power to purchase and maintain insurance on  
92 behalf of any agent of the limited liability company against any liability asserted against or  
93 incurred by the agent in that capacity or arising out of the agent's status as such whether or not  
94 the limited liability company would have the power to indemnify the agent against that liability  
95 under this section. The fact that a limited liability company owns all or a portion of the shares of  
96 the company issuing a policy of insurance shall not render this subdivision inapplicable if either  
97 of the following conditions are satisfied: (1) if the articles authorize indemnification in excess of  
98 that authorized in this section and the insurance provided by this subdivision is limited as

99 indemnification is required to be limited by paragraph (11) of subdivision (a) of Section 204; or  
100 (2)(A) the company issuing the insurance policy is organized, licensed, and operated in a manner  
101 that complies with the insurance laws and regulations applicable to its jurisdiction of  
102 organization, (B) the company issuing the policy provides procedures for processing claims that  
103 do not permit that company to be subject to the direct control of the limited liability company  
104 that purchased that policy, and (C) the policy issued provides for some manner of risk sharing  
105 between the issuer and purchaser of the policy, on one hand, and some unaffiliated person or  
106 persons, on the other, such as by providing for more than one unaffiliated owner of the company  
107 issuing the policy or by providing that a portion of the coverage furnished will be obtained from  
108 some unaffiliated insurer or reinsurer.

109 (j) This section does not apply to any proceeding against any trustee, investment  
110 manager, or other fiduciary of an employee benefit plan in that person's capacity as such, even  
111 though the person may also be an agent as defined in subdivision (a) of the employer limited  
112 liability company. A limited liability company shall have power to indemnify such a trustee,  
113 investment manager, or other fiduciary to the extent permitted by subdivision (f) of Section 207.

(Proposed new language underlined; language to be deleted stricken.)

**PROPONENT:** Beverly Hills Bar Association

## **STATEMENT OF REASONS**

Existing Law: While Corporations Code section 317 on which the proposed statute is based provides to agents and employees of corporations a right to be indemnified by the corporation that employs them in “an action by or in the right of the corporation,” agents and employees of limited liability companies lack such a right. In *Nicholas Laboratories, LLC v. Chen* (2011) 199 Cal.App.4<sup>th</sup> 1240, the Fourth District Court of Appeal “conclude[d] Corporations Code section 317 is inapplicable to limited liability companies” and denied the claim of an employee to recover costs and fees incurred in successfully defending a claim by the limited liability company that employed him.

This Resolution: This resolution would add a section to Chapter 1 of Title 2.5 of the Corporations Code, Beverly-Killea Limited Liability Company Act, based on Corporations Code section 317, to provide employees and agents of limited liability companies the same indemnity rights the law currently provides to employees and agents of corporations.

The Problem: There is no good reason to deny to employees of limited liability companies indemnity rights against their employers just because of the form of entity.

## **IMPACT STATEMENT**

This resolution does not affect any other law, statute, or rule.

**AUTHOR AND/OR PERMANENT CONTACT:** Michael R. Sohigian, 10940 Wilshire Boulevard, Eighteenth Floor, Los Angeles, CA 90024; (310) 914-2494 (phone); (310) 914-2484 (fax); [msohigian@mrslaw.net](mailto:msohigian@mrslaw.net)

**RESPONSIBLE FLOOR DELEGATE:** Mike Sohigian

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**COUNTER-ARGUMENT(S) TO RESOLUTION 03-07-2012**

**SACRAMENTO COUNTY BAR ASSOCIATION**

Resolution 03-07-2012 is unnecessary because Corporations Code section 17155 already authorizes the articles of organization or operating agreement to provide for indemnification of any agent of the LLC (including any manager, member, officer, employee) against any judgments, settlements, penalties, fines or expenses of any kind incurred as a result of acting in the capacity of an agent. Adding a new Section 17159 is not only unnecessary, but it is inconsistent with the existing Section 17155 that already authorizes indemnification. If the proponent would like to change the current LLC indemnification law to *require*, rather than *permit*, the LLC to indemnify any agent who was successful on the merits of a claim or proceeding (as is the case with corporations in Corporations Code section 317(d)) then the proponent should propose an amendment to the existing Section 17155.

**SAN DIEGO COUNTY BAR ASSOCIATION**

Limited liability companies are different from corporations in numerous respects, including their inability to conduct certain types of businesses or provide services which require a license. They are typically used by individuals and corporations to hold a single asset, or to conduct a single type of business.

The resolution defines the term “agents” who are entitled to indemnification to include members, i.e., owners of the subject entity. California Corporations Code section 317 does not provide indemnification rights to owners, i.e., shareholders. California Corporations Code section 317 is convoluted, difficult to read and ambiguous as to whether the indemnification rights it offers are permissive or mandatory. Many of its provisions are drafted presumably to protect the owners, shareholders of the corporation. This resolution would repeat the ambiguities and difficulties of Corporations Code section 317, and would include those owners as having a right to indemnification.

Finally, true employees of an LLC already have the indemnification rights provided by Labor Code section 2802. The title of this resolution is misleading in its reference to providing “employees” with indemnification rights. It is also misleading in stating that the indemnification it would provide would be “mandatory.” Neither California Corporations Code section 317 nor this resolution, which parrots its wording, are at all clear as to anything mandatory, and deal primarily with that which the subject entity has the power and the discretion to do.

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