July 25, 2006

The Honorable H. Walter Croskey
The Honorable Patti S. Kitching
The Honorable Richard D. Aldrich
Court of Appeal
Second Appellate District, Division Three
300 South Spring Street
Second Floor, North Tower
Los Angeles, California 90013-1213

Re: **Morgan, Lewis & Bockius v. Cassady**
2d Civ. No. B177747

Honorable Justices:

On behalf of respondent and appellant Ralph Cassady, we respectfully submit the following responses to the three issues raised in the Court's June 22, 2006 "Order Vacating Submission and for Further Briefing."

1. Please provide citation to authority, if any, holding that the employee has the burden to prove, for purposes of a Labor Code section 2802 indemnity claim, that his or her expenses were incurred in direct consequence of the discharge of his or her duties.

We know of no authority directly on point. In general, however, the burden of proof must be allocated according to principles of fairness and sound public policy. (*Webster v. Trustees of Cal. State University* (1993) 19 Cal.App.4th 1456, 1464; Evid. Code, § 500 ["*Except as otherwise provided by law*, a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting" (emphasis added)].) The Law Revision Commission comment to Evidence Code section 500 explains that in determining the allocation of the burden of proof, "courts consider a number of factors: the knowledge of the parties concerning the particular fact, the availability of the evidence to

the parties, the most desirable result in terms of public policy in the absence of proof of the particular fact, and the probability of the existence or nonexistence of the particular fact. In determining the incidence of the burden of proof, 'the truth is that there is not and cannot be any one general solvent for all cases. It is merely a question of policy and fairness based on experience in the different situations.'" (Cal. Law Revision Com. com., 29B West's Ann. Evid. Code, § 500, p. 554, quoting from 9 Wigmore, Evidence (3d ed. 1940) § 2486, p. 275.)

We submit that where, as here:

- the reimbursement claimed by an employee is for litigation expenses in the defense of a lawsuit brought by a former client against the employer law firm, against certain partners in the law firm, and against the employee attorney, and

- on the face of it, the lawsuit arises from the employee's services in the course and scope of the employment relationship, and

- the employee tenders the defense to his employer before incurring the expenses, and

- the employer fully participates in the defense of the lawsuit for itself and for its partners but not for its employee,

fairness and sound public policy require that the burden of proof as to whether the employee's expenses were incurred in direct consequence of the discharge of the employee's duties should fall on the employer. (*Webster v. Trustees of Cal. State University*, *supra*, 19 Cal.App.4th at p. 1464 [university professor challenged decision to terminate his tenured employment; held, "fairness and sound policy require placing the burden of proving appellant's job performance or lack thereof on the trustees"].)

Of course, whichever party may have the ultimate burden of proof at trial, the moving party on a motion for summary judgment always has the burden of proving that the opposing party has no evidence, and cannot reasonably obtain evidence, to support its

claim or defense. (Code Civ. Proc., § 437c, subd. (p)(2); *Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 854.)

Morgan Lewis was the moving party in this case, and Morgan Lewis did not and cannot carry its burden of proof as to Mr. Cassady's claim for indemnification under Labor Code section 2802. Mr. Cassady was employed as an attorney by Morgan Lewis from February 1987 to March 1988 (JA 291:11-22) and the *Rallis* complaint against Morgan Lewis, certain Morgan Lewis partners and Mr. Cassady was based in substantial part on Mr. Cassady's conduct as a Morgan Lewis employee. The *Rallis* complaint alleged malpractice and negligent misrepresentation against Morgan Lewis, its partners and Mr. Cassady arising in part from "legal activities undertaken by [them] during the period of October 1987 through February 1988." (JA 361:21-22.) The second and eighth causes of action of the *Rallis* complaint dealt exclusively with a transaction involving a sale of stock and an indemnity agreement (called the "Ackers" or "AHLC" transaction) in that exact period of time. (2JA 361-364, 372-373.) The declaration of Mr. Cassady's attorney (2JA 299, ¶ 4), the attorney's detailed bills (2JA 301-321),[1] the allegations of the *Rallis* complaint (2JA 347-377, ¶¶ 40, 43, 46, 63-73, 87-96, 114-116) and the Court of Appeal's decision in the *Rallis* case (2JA 392-407), establish that significant effort was invested by the attorney on Mr. Cassady's behalf in successfully defending against the malpractice claims relating to Mr. Cassady's employment with Morgan Lewis.

In short, the burden of proof on the motion for summary judgment and at trial should be on Morgan Lewis. Morgan Lewis did not and cannot carry that burden.

---

[1] Fees for services related solely to the Ackers transaction can be identified by simply reading the bills from Mr. Cassady's attorney in the *Rallis* action, Baird A. Brown. (See, for example, 7/1/98 ["Review documents regarding Ackers issues"]; 7/14/98 ["Confer with Hager and Kruis regarding AHLC documents"] (2JA 318-319).) The same is true for fees solely related to the second summary judgment, which only addressed the Ackers transaction. Attorney Baird A. Brown's statements spell it out. (See, for example, 12/16/98 ["Work on motion for summary judgment"]; 12/17/98 [same]; etc., almost every day through 2/19/99 ["Attend summary judgment hearing"] (2JA 316-317).)

2. Should analogous contractual indemnity principles applied in the insurance context apply to the question of an employer's duties to indemnify and defend under Labor Code section 2802? Why or why not?

Indemnifiable expenses under section 2802 include attorney fees incurred by the employee in defense of lawsuits brought against the employee as a consequence of his or her duties of employment. (See *Devereaux v. Latham & Watkins* (1995) 32 Cal.App.4th 1571, 1583; *Los Angeles Police Protective League v. City of Los Angeles* (1994) 27 Cal.App.4th 168, 177; *Douglas v. Los Angeles Herald- Examiner* (1975) 50 Cal.App.3d 449, 465; see also *20th Century Ins. Co. v. Choong* (2000) 79 Cal.App.4th 1274, 1277 [attorney's employer law firm liable for sanction imposed on attorney during representation of firm client].)

Analogous duties of a liability insurer to indemnify and defend its insured should apply to an employer's duty to indemnity and defend under Section 2802. This is because the insurer-insured relationship and the employer-employee relationship are both infused with similar extra-contractual duties based on important public policy considerations.

In the insurer-insured relationship, public policy requires that the insurer undertake the prophylactic duty to defend its insured if there is any potential for coverage under the insured's liability policy, even if it turns out there is no coverage. (*Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 271-281.) In such cases, "[t]he insurer bears the burden of proving by a preponderance of the evidence that the claim is not even potentially covered." (*State of California v. Pacific Indemnity Co.* (1998) 63 Cal.App.4th 1535, 1547.)

As in the case of insurance, even though the allegations of the complaint against the employee may prove to be unfounded, the employee still has to defend against them and the employee is entitled to indemnity. "The employee who is sued for authorized acts in the scope of his employment is as much in need of and deserving of indemnity if the third person acts in bad faith as the employee is if the third person acts in good faith." (*Douglas v. Los Angeles Herald-Examiner*, *supra*, 50 Cal.App.3d at p. 462.)

As in the case of insurance, employers also are subject to extra-contractual obligations. The payment of wages, for example, is tightly regulated (and even subject to criminal prosecution) to ensure that employees are promptly and fully paid all that is due for their services. (Lab. Code, §§ 201, 202, 216, 221, 222, 223, 224, 1175, 1199.) As this Court held in *Phillips v. Gemini Moving Specialists* (1998) 63 Cal.App.4th 563, "One need only examine provisions in the Labor Code to realize that 'the prompt payment of wages due an employee is a fundamental public policy of this state.'" (*Id.* at p. 571, 574, quoting *Gould v. Maryland Sound Industries, Inc.* (1995) 31 Cal.App.4th 1137, 1147, and citing *Pressler v. Donald L. Bren Co.* (1982) 32 Cal.3d 831, 837.)

Payment of an employee's expenses incurred in the discharge of the employer's work is closely akin the payment of wages for that work. Labor Code section 2802, subdivision (a), provides:

> 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.

"[T]he obvious purpose of [section 2802] is to protect employees from suffering expenses in direct consequence of doing their jobs." (*Grissom v. Vons Companies, Inc.* (1991) 1 Cal.App.4th 52, 60.) The public policy motivating Section 2802 is so strong that Labor Code section 2804 provides:

> Any contract or agreement, express or implied, made by any employee to waive the benefits of this article or any part thereof, is null and void, and this article shall not deprive any employee or his personal representative of any right or remedy to which he is entitled under the laws of this State.

There is a similar policy with regard to corporate agents. Corporations Code section 317 provides that a corporation must indemnify an agent if he or she is successful on the merits in defense of a proceeding arising out of performance of corporate duties. *Plate v. Sun-Diamond Growers* (1990) 225 Cal.App.3d 1115, explains why:

> The policy considerations behind these statutes are that persons who serve the corporation in good faith should, in the absence of certain conduct (fraud, breach of fiduciary duties, etc.) be free from liability for corporate acts; indemnification encourages capable persons to perform their duties, secure in the knowledge that expenses incurred by them despite their honesty and integrity will be borne by the corporation.

(*Id.* at pp. 1122-1123; see also *APSB Bancorp v. Thornton Grant* (1994) 26 Cal.App.4th 926, 931 [§ 317 construed broadly to encompass independent contractor who functions as corporate agent].)

In light of these public policy considerations, an employer should be treated like an insurer of its employees with regard to expenses incurred by the employee as a consequence of the employee's work for the employer's benefit, and the employer should be obligated to defend the employee in the first instance as well as indemnify the employee after the expenses are already incurred. This will encourage employees to perform their employer's work as directed, "secure in the knowledge that expenses incurred by them despite their honesty and integrity will be borne by" their employers. (*Plate v. Sun-Diamond Growers, supra*, 225 Cal.App.3d at p. 1123.)

Accordingly, analogous insurance indemnity and defense principles should apply, as the court did in fact apply them in *Jacobus v. Krambo Corp.* (2000) 78 Cal.App.4th 1096:

> [Section 2802] requires the employer not only to pay any judgment entered against the employee for conduct arising out of his employment but also to defend an employee who is sued for such conduct.

(*Id.* at p. 1100; accord, *Plancarte v. Guardsmark, LLC* (2004) 118 Cal.App.4th 640, 647-648 ["This statute obligates the employer not only to pay any judgment entered against the employee for conduct arising out of his employment but also to defend an employee sued by a third person for such conduct"]; *Douglas v. Los Angeles Herald- Examiner supra*, 50 Cal.App.3d at p. 461 ["We have no doubt that Labor Code section 2802 requires an employer to defend or indemnify an employee who is sued by third persons for conduct in the course and scope of his employment"].)

Not all cases appear to agree that the employer's duty to indemnify includes the duty to defend. (*Grissom v. Vons Companies, Inc.*, *supra*, 1 Cal.App.4th at p. 57 [in dictum, "Section 2802 does not say that an employer must 'defend' an employee"].) But even if the duty were only to indemnify for a defense rather than to provide a defense, the employer still should be obligated to indemnify for defense costs as those costs are incurred, and should not be permitted to force the employee, as Morgan Lewis forced Mr. Cassady here, to pay those costs first and seek indemnity later. As between employer and employee, the duty to provide a defense under Section 2802 should fall in the first instance on the employer.

3. Please provide further briefing on how common law indemnity principles do, or do not, apply to the facts alleged here, i.e., when a lawyer seeks indemnity from his employer law firm in relation to a client malpractice claim alleged against both.

Morgan Lewis does not dispute that Mr. Cassady was its employee. In the context of liability to third persons for the conduct of an employee, the employee is the agent of his employer-principal. (*Heiner v. Kmart Corp.* (2000) 84 Cal.App.4th 335, 350; Rest.2d Agency, § 2, com. a, p. 13.) "As a general rule, an agent is entitled to indemnification by its principal for losses incurred by the agent in the execution of the agency." (*Fidelity Mortgage Trustee Service, Inc. v. Ridgegate East Homeowners Assn.* (1994) 27 Cal.App.4th 503, 509-510.)

Citing to the Restatement Second of Agency, the *Fidelity Mortgage* case explains that the principal's obligation to indemnify its agent for losses incurred in the course of employment includes indemnity for expenses incurred in the course of conduct of the agency:

> The Restatement Second of Agency provides that a principal has a duty to its agent "who is not barred by the illegality of [her or] his conduct" to indemnify the agent for "expenses of defending actions by third persons brought because of the agent's authorized conduct, such actions being unfounded but not brought in bad faith . . . ." [Citation.] The comment to section 438 explains that instances in which the principal has a duty to indemnify its agent include "those [situations] in which the agent has

> suffered a loss which may not have benefitted the principal but in which liability depends upon a conception that because the agent was performing the principal's business it is fair that the principal should bear the incidental losses, such as the rule that the principal should indemnify the agent for the expenses of defending an action against [her or] him because [she or] he acted for the principal, the action being ultimately unsuccessful." (Rest.2d Agency, § 438, com. a, p. 324.)

(*Id.* at p. 509.)

The *Fidelity Mortgage* case also explains that an agent's indemnifiable expenses include attorney's fees incurred in defense of his conduct:

> Section 439, subdivision (d) of the Restatement Second of Agency provides in pertinent part: "Unless otherwise agreed, a principal is subject to a duty to exonerate an agent who is not barred by the illegality of [her or] his conduct to indemnify [her or] him for: . . . [¶] (d) expenses of defending actions by third persons brought because of the agent's authorized conduct, such actions being unfounded but not brought in bad faith . . . ." The comment to section 439, subdivision (d) states: "An agent who has done an authorized act which brings him into contact with others, such as the making of a contract or the taking possession of a chattel, is ordinarily entitled to indemnity for the expenses of a successful defense to actions brought by third persons acting under the mistaken belief that the agent's conduct was a breach of contract, a tort, or otherwise created liability to them. If the action is the result of a reasonable mistake of law or fact by the third person, it is within the risks attendant upon authorizing the conduct and one which the principal customarily assumes." [Citation.] The "expenses" of a successful defense for which indemnification is claimed by an agent ordinarily include attorney fees. [Citation.]

(*Id.* at pp. 510-511.)

In short, even apart from Labor Code section 2802, under governing principles of agency and employment law, Morgan Lewis had the obligation to indemnify Mr. Cassady

for expenses he incurred in defending litigation brought against him as a consequence of his conduct in discharge of his duties on behalf of Morgan Lewis. Morgan Lewis' summary judgment motion does not effectively address Mr. Cassady's right to indemnity under the common law. For this additional reason, the Morgan Lewis summary judgment motion fails as a matter of law.

Respectfully submitted,
LAW OFFICES OF BAIRD A. BROWN
BAIRD A. BROWN

GREINES, MARTIN, STEIN & RICHLAND LLP
MARC J. POSTER

By _____
Marc J. Poster

Attorneys for Respondent and Appellant Ralph Cassady