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Case No. _____

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SHARMALEE GOONEWARDENE, an individual,

Plaintiff and Appellant,

vs.

ADP, LLC; ADP PAYROLL SERVICES, INC.; AD PROCESSING, LLC,
Defendants and Respondents.

On Review of a Decision of the California Court of Appeal,
Second Appellate District, Division Four, No. B267010

On Appeal from the Superior Court of California,
County of Los Angeles
The Hon. William Barry, Judge
Civil Case No. TC026406

PETITION FOR REVIEW

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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

Pursuant to California Rules of Court, Rule 8.208, Defendants, Respondents and Petitioners ADP, LLC and ADP Payroll Services, Inc. hereby notifies the Court that ADP, LLC and ADP Payroll Services, Inc. are 100% owned by Automatic Data Processing, Inc. No other publicly-held company owns stock in ADP, LLC or ADP Payroll Services, Inc.

Dated: December 14, 2016

MORGAN, LEWIS & BOCKIUS LLP

By: _____

Robert A. Lewis
Attorneys for Defendants, Respondents and Petitioners ADP, LLC; ADP PAYROLL SERVICES, INC.; AD PROCESSING, LLC

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I. STATEMENT OF ISSUES

For more than 60 years, individuals and businesses have assisted California employers with their non-delegable obligation to properly pay their employees. Petitioner ADP, LLC ("ADP") is one of the many businesses that provide payroll services to thousands of California employers. Until the court of appeal decision here, an employee's recourse for challenging an allegedly improper wage payment—whether or not a third-party payroll service provider was involved—was well-established, functioned effectively and involved only the employer who owed the wages. The employee made a wage claim against his or her employer pursuant to the Labor Code provisions the legislature established to ensure employees are paid properly and promptly. If the employee was wrong, the claim ended there. If the employee was right, the employer paid the wages it owed. Separately from resolution of the employee's wage claim, the contract between the employer and its payroll service provider determined what recourse might be available to the employer if a payroll service provider's error contributed to an improper wage payment.

Over the years, some employees tried to enmesh payroll service providers into this long-established statutory resolution process, generally on arguments that payroll service providers are employers or co-employers of their clients' employees. Indeed, plaintiff Goonewardene here attempted to do exactly that. But California courts uniformly have rejected such efforts, as the court of appeal did here in affirming the trial court's rejection of Plaintiff's claims under the

Labor Code. Opinion ("Op.")-12-20.

But while affirming the law that payroll service providers cannot be liable under the Labor Code for the improper payment of wages, the court of appeal inexplicably invented new law that would allow employees to bring wage claims against payroll service providers through the back door. In holding that employees are third-party beneficiaries of the contracts between employers and payroll service providers—and for that reason may also pursue tort claims for professional negligence and negligent misrepresentation against payroll service providers—the court of appeal disrupts the law that efficiently has resolved employee wage disputes for decades. It is no exaggeration to say that the court of appeal's decision will mean that payroll service providers now routinely will become defendants in existing and future wage and hour lawsuits simply because they assisted employers in discharging their non-delegable duties to pay wages.

It is also no exaggeration to say that this extraordinary change in California law will complicate and delay wage and hour lawsuits and increase the expenditure of time and expense by the parties and trial courts, with no compensating benefit for anyone. Wage and hour litigation is about whether an employee was properly paid, irrespective of the possible involvement of third-party payroll service providers. The court of appeal's newly-recognized causes of action are wholly redundant to the claims the Labor Code and the employment relationship make available to employees to ensure that employers properly pay the wages they promised to pay. Indeed, because the court of appeal recognized

two tort claims against payroll service providers that are not available to employees against their employers under the Labor Code, its decision perversely exposes payroll service providers, because of the differences between tort and contract damage measures, to potentially greater liability than the employers who promised the wages to their employees and benefitted from their work.

This Court therefore should review the following issues:

Issue One. Does California law and public policy, explicitly recognized in the trial court's order and ignored by the court of appeal, prohibit the blurring of responsibility between the employer and its third-party payroll service provider and place exclusively on the employer the obligation to pay employee wages, a bright line rule that recognizes that the employer's duty to pay wages is non-delegable?

Issue Two. Are employees third-party creditor beneficiaries of contracts by which their employers secure assistance in preparing wage payments and wage statements such that they may sue payroll service providers and hold them responsible in contract for compliance with Labor Code obligations that apply only to employers and are part of employers' non-delegable duties to provide their employees with legally-compliant wages and wage statements?

Issue Three. If employees are third-party beneficiaries of the contracts between employers and payroll service providers, do payroll service providers also owe a duty to their clients' employees that supports tort claims for professional negligence and negligent misrepresentation, despite this Court's decisions

restricting tort remedies that seek to either redress contract breaches or to recover purely economic losses like the wages claimed by the Plaintiff here?

Issue Four. If employees are not third-party beneficiaries of the contracts between employers and payroll service providers, do payroll service providers nevertheless owe a duty to their clients' employees that supports tort claims for professional negligence and negligent misrepresentation that would potentially expose payroll service providers to greater liability than the employers who promised the wages to their employees and benefitted from their work?

Review of these four issues is not only crucial to every individual and business that provides payroll services to California employers, but also, in light of the court of appeal's stated reasoning, crucial to any individual or business that provides any service to California employers that may be characterized as benefitting the employer's employees.

II. STATEMENT OF THE CASE[1]

A. Routine Employment Litigation Alleging Wage And Hour Claims Morphs Into A Suit Against The Employer's Payroll Service Provider

This case started out as a single-plaintiff, garden-variety wage and hour case. In April 2012, plaintiff-appellant Sharmalee Goonewardene sued her former

[1] Appellant's court of appeal appendix is cited "AA-__." Respondents' appendix is cited "RA-__." The court of appeal's November 4 opinion is cited "Op.-__" and the November 29 modification as "M-Op.-__."

employers, Altour,[2] alleging employment-related claims spanning seven years: failure to pay wages, wrongful termination, and racial discrimination. (1-AA-3)

The case turned atypical when, two years into the case and just months from the trial date, Goonewardene secured leave to add an additional defendant: Altour's third-party payroll processing vendor ADP. (1-AA-12, 23) The effort late in the litigation to add Altour's payroll service provider, if anything more than a tactic to delay the trial date, was particularly curious, since under no circumstances could the payroll service provider be involved in the claims for wrongful termination or racial discrimination. Goonewardene's fourth amended complaint ("4AC") named ADP as a defendant only on a single cause of action (the thirteenth) under California's Unfair Competition Law (UCL), Bus. & Prof. Code §17200, and not on the 4AC's employment-related causes of action. (RA-3)

ADP demurred. (1-AA-12) Initially, the court deferred ruling because Goonewardene sought leave to file a Fifth Amended Complaint ("5AC"). (*Id.* at 37, 66, ¶1) The 5AC added two more ADP-related entities as defendants: AD Processing, LLC (the name under which ADP does business in California) and ADP Payroll Services, Inc. (which was not Altour's payroll service provider and had nothing to do with the allegations in this case). (2-AA-76-77, ¶¶6-8) ADP opposed leave to amend. (1-AA-10)

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[2] Altour allegedly comprises two corporations (in New York and California) named Altour International, Inc. 2–AA–78-80, ¶¶14-32, 2-AA-89, ¶102.

B. The Trial Court Rejects Plaintiff's Attempt To Blur The Employers' Non-Delegable Duty To Pay Wages And Comply With Labor Code Requirements

Ruling on both ADP's demurrer to the 4AC and plaintiff's motion for leave to file her 5AC, the trial court sustained the demurrer. It struck and dismissed all allegations based on ADP's alleged status as Goonewardene's employer. (RA-66, ¶¶3-5(f)) Nevertheless, the trial court allowed Goonewardene to try to plead causes of action based on something other than the theory that ADP was Goonewardene's "employer." (*Id.*)

Goonewardene's 5AC, a veritable laundry list of California causes of action, alleged six new claims against the ADP-payroll-processing defendants:

1. professional negligence (13th cause of action);
2. negligent misrepresentation (14th cause of action);
3. violation of B&P Code §17200 based on alleged misrepresentation (15th cause of action);
4. violation of B&P Code §17500, false advertising (17th cause of action);
5. third-party beneficiary breach of contract (18th cause of action); and
6. aiding and abetting (19th cause of action).

(2-AA-97-103)

Demurrer to the 5AC was sustained without leave to amend in a thoughtful and highly-detailed order. (1-AA-33-34) The trial court summarized its analysis thus:

> The fundamental approach in the Court's rulings herein is that Plaintiff is asking the Court to blur the responsibility between the employer and its third party payroll processing vendor, and, based on the legal authorities the Court has reviewed, the Court believes that to do so would be contrary to public policy. The Court believes that the focus has to be exclusively on the *employer's* obligation to pay employees' wages, and that there needs to be a bright line obligation in that regard. As the case law has made clear, an employer's obligation to make sure its payroll checks are accurate and that its employees are properly paid their wages is "non-delegable."

1–AA–33:19-27 (emphasis original).[3]

While the form of judgment and order were being settled, Goonewardene sought reconsideration and filed a proposed Sixth Amended Complaint ("6AC"), which embellished some of the 5AC's allegations.[4] (1-AA-37). The trial court did not rule on the reconsideration motion. Judgment was entered on August 5, 2015. (1-AA-25)

C. The Court Of Appeal Follows California Law And Holds That Employees May Not Sue Payroll Service Providers For Wage And Hour-Related Labor Code Violations

On appeal, plaintiff did not defend the 5AC's sufficiency. Op.-6-7. Therefore, all claims in the 5AC were properly dismissed by the trial court. The court of appeal considered whether the proposed 6AC—and therefore just the new

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[3] The 5AC doubled down on the theory that Altour's payroll service provider was plaintiff's employer, alleging all of Goonewardene's employment-related claims against newly-added defendants AD Processing, LLC and ADP Payroll Services, Inc. (1-AA-84-97) Not surprisingly, the court sustained the demurrer to these causes of action on the same basis it sustained ADP's earlier demurrer. (1-AA-1-2)

[4] As it pertains to ADP, the 6AC adds new allegations (they appear in redline) in paragraphs 139-157, 160 and 162, 170-171 and 184-186.

material inserted beyond the 5AC's allegations—stated any cause of action such that leave to amend should have been allowed. Op.-7-8.

The 6AC alleged (unchanged from the 5AC) "claims against ADP for failure to make timely wage payments (Lab. Code, §§201, 201.3, 201.5, 202, 203, 205.5; second cause of action), failure to pay overtime compensation (Lab. Code, §1194; tenth cause of action), and failure to issue adequate earnings statements (Lab. Code, §226, eleventh cause of action)." Op.-13.

The court of appeal held that ADP could not be sued for these alleged Labor Code violations because ADP was not plaintiff's employer. The court found "persuasive" and "appl[ied]" the "analysis" of *Futrell v. Payday California, Inc.* (2010) 190 Cal.App.4th 1419, which it quoted in part:

> "[W]e conclude that 'control over wages' means that a person or entity has the power or authority to negotiate and set an employee's rate of pay, and not that a person or entity is physically involved in the preparation of an employee's paycheck. This is the only definition that makes sense. The task of preparing payroll, whether done by an internal division or department of an employer, or by an outside vendor of an employer, does not make [the preparer] an employer for purposes of liability for wages under the Labor Code wage statutes. The preparation of payroll is largely a ministerial task, albeit a complex task in today's marketplace. The employer, however, is the party who hires the employee and benefits from the employee's work, and thus it is the employer to whom liability should be affixed for any unpaid wages. The extension of personal liability to the agents of an employer is not reasonably derived from the language and purposes of the Labor Code wage statues."

Id. at 1432.[5]

D. The Court Of Appeal Creates New Law That Employees May Sue Their Employers' Payroll Service Providers As Third Party Beneficiaries Of The Contracts Under Which Payroll Service Providers Assist Employers And Under The Torts Of Professional Negligence and Negligent Misrepresentation

Reviewing a "prolix and poorly organized 6AC," Op.-9, fn.3, the court of appeal imposed on payroll service providers liability for violations of the same Labor Code duties that it found applicable only to employers and that do not support direct causes of actions against those who assist with payroll preparation. The court concluded that employees are third-party creditor beneficiaries of the contracts by which employers procure payroll assistance. Op.-23.

The court of appeal purported to apply the third party beneficiary contract rights framework set out in the FIRST RESTATEMENT OF CONTRACTS, dividing third party beneficiaries between creditor and donee beneficiaries. "A person cannot be a creditor beneficiary unless the promisor's performance of the contract will discharge some form of legal duty owed to the beneficiary by the promisee." Op.-23. The court of appeal initially concluded: "when a business enters into a contract with a service provider clearly aimed at aiding the business in discharging its duty to supply information or benefits to certain individuals, those individuals constitute third party beneficiaries of the contract between the business and the service provider." Op.-25.

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[5] For similar reasons, the court held the ADP defendants could not be sued on federal statutory claims for failure to pay overtime compensation, Op.-19-20, employment discrimination, or wrongful termination. Op.-20-22.

The court then evaluated the 6AC and concluded that it alleged an unwritten contract under which "ADP provided payroll calculation, records maintenance, legal advice and a host of related services to Altour for the benefit of Altour and its employees in the general area of employee wages and benefits." Op.-26, quoting 6AC. The court downplayed Plaintiff's appellate argument that "ADP received only a record of Plaintiff's hours per day, generated by Plaintiff, and used that information to provide Plaintiff with a paycheck and earnings statement on a semi-monthly basis. ADP had no ability whatsoever to determine whether Plaintiff took or missed a meal or rest break, and calculated Plaintiff's pay on the assumption that Plaintiff never missed a break." (AOB–2) In the court of appeal's view, "the 6AC expressly attributed [to the ADP defendants] some of the alleged misconduct..." that allegedly caused Plaintiff not to be fully compensated and to receive deficient wage statements. Op.-2. This all meant to the court of appeal that "[t]he 6AC thus alleges that Altour employees such as appellant are, at a minimum, third party creditor beneficiaries of the unwritten agreement." Op.-26.[6]

Based largely on its determination that Plaintiff is an alleged third-party creditor of an unwritten payroll services contract entered into by Altour, the court

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[6] In a companion footnote, the court speculated that Altour employees might arguably be third-party donee beneficiaries because of allegations that ADP provided employees "a mechanism...to access information and track their earnings." Op.-26, fn.5. In the end, however, the court made no holding about donee beneficiary status. The court's speculation is baseless, since there was no "donated" aspect of the ADP-Altour contract.

concluded that ADP owed a duty of care to Plaintiff and other Altour employees to prepare legally-compliant paychecks and wage statements. The court confirmed its duty finding by applying the factors outlined in *Biakanja v. Irving* (1958) 49 Cal.2d 647, and later explicated in *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 376. Op.-41-42. With a duty recognized, the court concluded that a cause of action for professional negligence was stated. Op.-41.

Turning to Plaintiff's alleged tort of negligent misrepresentation, the court reasoned that a cause of action was stated against ADP based, again, on the court's third-party beneficiary determination. Further, in the court's view, Plaintiff's allegations overcame the restriction that a negligent misrepresentation claim only lies against a professional service provider if the plaintiff was a "specifically intended beneficiary of the information supplied by the professional." Op.-31, *citing Murphy v. BDO Seidman* (2003) 113 Cal.App.4th 687, 694.[7]

E. The Modified Appellate Opinion

In response to ADP's rehearing petition, the court of appeal modified its opinion in two respects. First, it changed its holding about the legal conditions necessary for third-party creditor beneficiary status. Abandoning its broad holding that third-party beneficiary status for an employee exists pursuant to "a contract with a service provider clearly aimed at aiding the business in discharging its duty to supply information or benefits to certain individuals...," the court instead held:

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[7] The court affirmed judgment for ADP on Plaintiff's causes of action for false advertising, unfair competition, and aiding and abetting. Op.-45-56.

"when an employer enters into a contract with a service provider by which the provider is to take over the employer's payroll tasks, including the preparation of the payrolls themselves, the employees constitute third party creditor beneficiaries of the contract between the employer and the service provider."[8] M-Op.-1-2.

Second, the court added a footnote rejecting ADP's argument that the economic loss rule forecloses a professional negligence cause of action. Without questioning the general applicability of the rule, the court reasoned that plaintiff's status as a third party contract beneficiary bestowed on plaintiff a "special relationship" that brought her within an exception to the economic loss rule and its restrictions on negligence causes of action that seek only recovery for economic damages. M-Op.-2-3.[9]

III. REASONS TO GRANT REVIEW

A. Review Is Warranted To Address California's Established Law and Public Policy Recognizing The Employer's Non-delegable Duty To Pay The Wages It Promised Its Employees

The decision here marks the first time any court has held that someone other than the employer is responsible for paying the wages of its employees.

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[8] The 6AC alleges a role for ADP far less than "tak[ing] over" Altour's "payroll tasks." *See*, post, topic 111.B.

[9] The court also noted that ADP did not raise the economic loss rule until its rehearing petition. M-Op.-2. Appellant's court of appeal briefs suggested no reason to raise the rule sooner. Moreover, the court of appeal cannot create a new, heretofore unrecognized cause of action that conflicts with this Court's precedent on the basis that one party did not mention the precedent sooner. Moreover, the economic loss rule is a facet of why no cause of action for professional negligence should be recognized—an issue ADP fully briefed in the trial court and on appeal.

That holding conflicts with established California law and sound public policy. The Labor Code places solely on employers a non-delegable duty to pay their employees' wages.

The court of appeal decision conflicts with this Court's holding that "no generally applicable rule of law imposes on anyone other than an employer a duty to pay wages." *Martinez v. Combs* (2010) 49 Cal.4th 35, 49. That holding confirms what, until this decision, had been self-evident—because an employer hires its employees and benefits from their work, it is solely responsible for paying them what it promised according to legal requirements. The holding in *Martinez* is relied upon by the court in *Aleksick v. 7-Eleven, Inc.* (2012) 205 Cal.App.4th 1176, where the court granted summary judgment for a payroll service provider against claims brought by an employee.

The decision also conflicts with the holding in *Futrell,* 190 Cal.App.4th at 1419, where the court explicitly recognized why employers have the sole duty to pay their employees:

> The employer, however, is the party who hires the employee and benefits from the employee's work, and thus it is the employer to whom liability should be affixed for any unpaid wages. The extension of personal liability to the agents of an employer is not reasonably derived from the language and purposes of the Labor Code wage statues.

And the decision conflicts with the Labor Code framework that employers must follow and that provides remedies for employer non-compliance. Indeed, *Aleksick* specifically recognized "the public policy in favor of *requiring employers*

to comport with Labor Code wage statutes and promptly and fully pay their employees." 205 Cal.App.4th at 1180.

The non-delegable nature of employer duties is apparent as a matter of statutory interpretation. Labor Code duties repeatedly fall on the "employer" and no one else. Under Labor Code §226(a), "[e]very *employer shall*...at the time of each payment of wages, furnish each of his or her employees...an accurate itemized statement in writing showing...." When wages are disputed, "*the employer* shall pay, without condition...," subject to various rights. Labor Code §206. Pay period interval obligations apply to the "employer." Labor Code § 204(a) & (c); *see also* "employer" references in Labor Code §§ 201, 203 & 203.1. "Shall" is mandatory. Labor Code §15. And when liability under the Labor Code is to be extended beyond the "employer," courts evaluate whether a "joint employer" situation is presented, not whether someone other than an "employer" is responsible. *See, e.g., Martinez,* 49 Cal.4th at 49.

Recently, the legislature broadened Labor Code liabilities beyond "employers," but only to "an owner, director, officer or managing agent of the employer" who is a "natural person." Labor Code §558.1. ADP does not fit within any of these categories. The court of appeal's decision has effectively recognized third-party liabilities that are broader than those the legislature sanctioned.

Moreover, recognizing liability for wage payment on the part of payroll service providers would be redundant to the liability provided by the Labor Code,

confer no benefit on employees or employers, and be wasteful. The employee's long-established right to obtain his or her full wages from the employer remains unchanged even if the employee were permitted now to bring a redundant claim against the payroll service provider that assisted the employer. Because the employee is only entitled to his or her promised compensation, a new right of action against a second defendant only ensures that determining whether an employee has received his or her promised compensation will take more time and cost more. And ultimately, since the law is clear that it is the employer who is responsible for fully paying its employees, a payroll service provider will have an indemnity right back against the employer for any judgment against it for improper payment of wages. Therefore, the court of appeal's decision creates a redundant, circular and wasteful new claim that benefits no one.

Established California law and public policy preclude the new path on which the court of appeal would have employees, employers, payroll service providers and the California legal system embark. This Court should review the decision.

B. Review Is Warranted To Address Whether California Employees Can Be Third Party Beneficiaries Of Their Employers' Contracts For Assistance With Preparing Payroll

The decision below also marks the first time any court has held that a contract to assist an employer with payroll confers third-party beneficiary rights on the employer's workers.

The court of appeal's third-party beneficiary conclusion, resting on its

creditor beneficiary analysis, derives from its assertion that payroll service providers "discharge some form of legal duty owed to the beneficiary [the employee] by the promisee [the wage-owing employer]." Op.-23, *quoting Martinez v. Socoma Companies, Inc.* (1974) 11 Cal.3d, 394, 400 (discharge of duty is test of creditor beneficiary). That conclusion is clearly wrong under established law. An employer's duties to comply with Labor Code wage preparation requirements may not be delegated by the employer. Consequently, a payroll service provider cannot "discharge" the employer's obligations. A contract between an employer and a payroll service provider cannot absolve the employer of its duty to properly pay wages to its employees according to legal requirements. If a payment is not made correctly, or not made at all, due to actions of the payroll service provider under the contract with the employer, the employer still has the duty to the employee to make good on the wages. The employer cannot avoid that responsibility by pointing to the payroll service provider.

By recognizing third party beneficiary rights, the court of appeal decision conflicts with the rule that employer Labor Code obligations are not delegable and also fails to honor the rule that the promisor in a third-party creditor beneficiary arrangement must be discharging the promisee's obligation to the beneficiary.[10]

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[10] This problem is not remedied by the court of appeal's change in its wording from "when a business enters into a contract with a service provider clearly aimed at aiding the business in discharging its duty to supply information or benefits to certain individuals, those individuals constitute third party beneficiaries of the

Third party beneficiary liabilities do not extend to employees and agents hired to assist in fulfilling employer/promisor obligations. While an employer's agents and employees may *aid* in discharging the employers' obligations, they do not *discharge* them. The employer retains at all times "a duty to pay wages," *Martinez*, 49 Cal.4th at 49, in a manner that complies with statutory requirements.

These factors differentiate this case from those where creditor beneficiary relationships have been recognized and used to establish third-party beneficiary contract rights. Creditor beneficiary cases in this Court involve situations where the promisor is to render *substitute performance* of the promissee's duty owed to a third party. *E.g.*, *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 Cal.2d 232, 244-245 (assignee of a lease assumes its obligations); *Calhoun v. Downs* (1931) 211 Cal. 766, 770-771 (agreement to assume obligation to pay brokerage commission). Stated different, full performance is to be rendered by the promisor to the third party beneficiary.

The allegations of plaintiff's 6AC are *not* that ADP discharges Altour's duties or renders substitute performance in place of Altour. The 6AC alleges that ADP provides "services" that assist Altour with wage payment and statements.

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contract between the business and the service provider" to "when an employer enters into a contract with a service provider by which the provider is to take over the employer's payroll tasks, including the preparation of the payrolls themselves, the employees constitute third party creditor beneficiaries of the contract between the employer and the service provider." Characterizing the service provider's work as "taking over" something from the employer does not mean the provider can discharge the employer's legal obligations.