

Case No. S238941

IN THE
SUPREME COURT OF THE STATE OF CALIFORNIA

SHARMALEE GOONEWARDENE, AN INDIVIDUAL,

Plaintiff and Appellant,

v.

ADP, LLC; ADP PAYROLL SERVICES, INC.; AD
PROCESSING, LLC,

Defendants and Respondents.

SUPREME COURT
FILED

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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

APPLICATION OF PAYCHEX, INC. FOR PERMISSION TO
FILE *AMICUS CURIAE* BRIEF AND PROPOSED BRIEF IN
SUPPORT OF DEFENDANTS, RESPONDENTS AND
PETITIONERS

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APPLICATION FOR PERMISSION TO FILE *AMICUS*
***CURIAE* BRIEF IN SUPPORT OF DEFENDANTS**
RESPONDENTS AND PETITIONERS

Pursuant to Rule 8.520(f) of the California Rules of Court, Paychex, Inc. (“Amicus” and/or “Paychex”) respectfully requests leave to appear as *amicus curiae* and file this proposed brief in support of Defendants, Respondents, and Petitioners, ADP LLC *et al.*

Pursuant to Rule 8.520(f)(4), no party’s counsel authored this brief in whole or in part; no party or party’s counsel contributed money that was intended to fund the preparation or submission of this brief; and no other person other than *amicus curiae*, its members, or its counsel contributed money that was intended to fund the preparation or submission of this brief.

STATEMENT OF INTEREST

Paychex, Inc., founded in 1979, is a provider of payroll processing and employee benefit services. (Paychex, Inc. Form 10-K (May 31, 2016) at 2.)¹ Paychex provides a variety of services and products that allow its clients to meet their diverse payroll processing needs. *Id.* Paychex serves a diverse base of small-to-medium-sized

¹ United States Securities and Exchange Commission, Form 10-K, Paychex, Inc. (May 31, 2016), <https://www.sec.gov/Archives/edgar/data/723531/000072353116000046/payx-20160531x10k.htm>

clients operating in a broad range of industries throughout the United States, including California. *Id.* Paychex uses service agreements and arrangements with clients that are generally terminable by the client at any time or upon a relatively short notice. (*Id.* at 6.) Paychex currently serves approximately 605,000 payroll processing clients throughout the United States. (*Id.* at 2.) The average client size within its existing client base is approximately 17 employees. (*Id.* at 6.)

The market for payroll processing services is highly competitive and fragmented. Paychex competes directly with national, regional, local and online payroll service providers. (*Id.* at 6.) Competition in the payroll service provider industry is primarily based on service responsiveness, product quality and reputation, ease of use, accessibility of technology, breadth of service products, and price. *Id.* The highly competitive nature of the industry, and the typical ease with which clients are able to terminate service agreements, results in increased competition among providers to be innovative and flexible in tailoring products and services to meet the clients' diverse needs. If the client is unhappy with the payroll service provider, it can easily contract with a different provider. Furthermore, if the client incurs liability to its employees resulting from a payroll

service provider's error, the service contract determines the employer's recourse against the payroll service provider.

Paychex has an interest in this proceeding because the decision in *Sharmalee Goonewardene v. ADP LLC et. al.*, ("*Goonewardene*") will have direct ramifications as binding legal precedent on the entire payroll service provider industry. *Goonewardene* will not only change the legal landscape for wage and hour litigation in California, it also alters the well understood boundaries between employers and payroll service providers and creates unnecessary confusion regarding the obligations and responsibilities between those parties.

A material aspect of Paychex's business model, and of the payroll service provider industry as a whole, is that payroll service providers *assist* clients in meeting their *non-delegable* obligations to properly pay their employees. The decision in *Goonewardene* substantially impacts the payroll service provider industry because it short-circuits the liability protections the service providers negotiate with their clients and subjects payroll service providers to unforeseen liability to their clients' employees with whom the payroll service provider has no relationship.

This shift in liability will significantly increase the cost of doing business in the industry given that payroll service providers will now face added litigation risks associated with wage and hour claims that are traditionally asserted against employers.

Goonewardene will, therefore, expose payroll service providers to staggering defense costs and to damages claims for wage and hour lawsuits. Increases in costs for payroll provider services will in turn directly impact employers' access to these services, potentially making such services cost prohibitive, resulting in less compliance and weakened protections for California workers. Moreover, the incorrect rulings in *Goonewardene* essentially eviscerate the concept of *non-delegable* employer responsibilities by placing upon a third party (*i.e.*, the payroll provider) employer responsibilities regarding individuals with whom they have no direct relationship.

Consequently, *Goonewardene* will have devastating consequences for the payroll provider industry and will negatively impact the countless California employers and employees that rely on these services.

To inform the Court about these matters, Paychex respectfully requests leave to file the accompanying *amicus curiae* brief.

PROPOSED BRIEF

INTRODUCTION

The decision in *Sharmalee Goonewardene v. ADP LLC et. al.*, (hereinafter “*Goonewardene*”) exposes payroll service providers to massive and unforeseen liability for their clients’ non-delegable obligations to properly pay their employees. In doing so, *Goonewardene* changes the legal landscape for wage and hour litigation in California, to the detriment of the entire payroll service provider industry and the countless California employers who depend on these services.

Specifically, *Goonewardene* significantly increases payroll service providers’ litigation risks, exposing payroll service providers to staggering defense costs and to damages claims for wage and hour lawsuits that are traditionally asserted against employers. The added litigation risks imposed by *Goonewardene* will have a devastating impact on the industry and will lead to significant increases in the prices for payroll provider services, potentially making such services cost-prohibitive to many California employers. California employers’ loss of access to payroll provider services will in turn result in less compliance and weakened protections for California workers. In

addition, the lower court's holding creates unnecessary confusion regarding the rights and obligations between an employer, its employees and the third party payroll service. Finally, federal and state wage and hour laws already provide ample avenues for employees to seek full remedy from their employers for unpaid wages and other Labor Code violations. Reversing, *Goonewardene* will, therefore, not leave employees without recourse, but rather, will restore the well-established and effective process pursuant to which California employees have long sought redress for wage payment violations.

Based on the foregoing, *amicus curiae* Paychex respectfully requests this Court to reverse the court of appeal's decision in *Goonewardene*.

STATEMENT OF FACTS

Paychex specifically adopts the Statement of the Case set forth in Petitioners' Opening Brief On The Merits, to the extent the facts are relevant and applicable for the purposes of this *amicus curiae* brief.

ARGUMENT

I. THE PAYROLL SERVICE PROVIDER INDUSTRY IS HIGHLY CONCENTRATED IN POPULOUS STATES LIKE CALIFORNIA, IS HIGHLY COMPETITIVE, AND SERVES A VAST NUMBER OF CALIFORNIA EMPLOYERS.

For over 60 years, payroll service providers have assisted countless employers in fulfilling their payroll obligations. Specifically, payroll service providers provide tools that assist clients in meeting their *non-delegable* obligations to properly pay their employees. In order to perform their work, payroll service providers depend on the data provided by their clients, including employees' hours and rates and other information about the client's work force. Payroll service providers range in size and sophistication and provide a variety of products and services including, generating paychecks, payroll reports, and tax filings for clients, that allow clients to meet their diverse payroll processing obligations and needs. (See Barnes Report, *2017 U.S. Industry & Market Outlook*, (Oct. 2016) at 6; Hoover's Inc., *Payroll Services First Research Custom Report*, (2017) at. 3.)²

² Retrieved July 7, 2017 from Hoover's database.

The United States is the “world’s primary market for payroll services.” (See Hoover’s Inc., *Payroll Services First Research Custom Report*, (2017) at. 3.) The payroll service provider industry in the United States includes approximately 5,900 establishments that generate an annual revenue of approximately thirty-three billion dollars. *Id.* In the United States, the industry is “most highly concentrated in populous states with large numbers of businesses.” (*Id.* at 5.) Consequently, California, Florida, New York, Texas, and Illinois have the most payroll service providers. *Id.* As of 2017, California had an estimated 1,162 payroll provider service establishments. (Barnes Report, *2017 U.S. Industry & Market Outlook*, (Oct. 2016) at 10.) That number is expected to increase to approximately 1,251 in 2018. (*Id.* at 16.)

Payroll service providers typically serve a diverse base of small-to-medium-sized clients operating in a broad range of industries throughout the United States, including California. (Paychex, Inc. Form 10-K (May 31, 2016)³ at 6; Hoover’s Inc., *Payroll Services*

³ United States Securities and Exchange Commission, Form 10-K, Paychex, Inc. (May 31, 2016), <https://www.sec.gov/Archives/edgar/data/723531/000072353116000046/payx-20160531x10k.htm>

First Research Custom Report, (2017) at 4.) Many of these clients typically employ fewer than 20 people. (Hoover’s Inc., *Payroll Services First Research Custom Report*, (2017) at 4; see Paychex, Inc. Form 10-K (May 31, 2016) at 6.) According to the National Payroll Reporting Consortium, its member payroll service providers serve more than 1.4 million employers, with a combined total of more than 35 million employees – more than one third of the private sector work force in the United States.⁴

The market for payroll processing services is highly competitive and fragmented. Competition in the payroll services industry is primarily based on service responsiveness, product quality and reputation, ease of use, accessibility of technology, breadth of service products, and price. (Paychex, Inc. Form 10-K (May 31, 2016) at 6.) Furthermore, Payroll service providers typically enter into service agreements with clients that are generally terminable by the client at any time or upon a relatively short notice. (Paychex, Inc. Form 10-K (May 31, 2016) at 6; Hoover’s Inc., *Payroll Services First Research Custom Report*, (2017) at 4.) Service contracts are typically not long-term and payroll service providers “depend on excellent

⁴ Available at: <http://www.nprc-inc.org/about.html>

service to ensure high contract renewal rates.” (Hoover’s Inc., *Payroll Services First Research Custom Report*, (2017) at 4.) The highly competitive nature of the industry, and the typical ease with which clients are able to terminate service agreements, results in increased competition among national, regional, local and online providers to be innovative and flexible in tailoring products and services to meet the clients’ diverse needs.

Given the high concentration of payroll service providers in California and the widespread use of payroll provider services among California employers, the *Goonewardene* decision will have a devastating impact on the industry as a whole and will adversely affect the countless California employers who rely on payroll provider services.

II. GOONEWARDENE WILL EXPOSE PAYROLL SERVICE PROVIDERS TO CRUSHING FINANCIAL BURDENS ASSOCIATED WITH DEFENDING WAGE AND HOUR LAWSUITS.

“Litigation is expensive, for the innocent as well as the wrongdoer.” *Reno v. Baird* (1998) 18 Cal. 4th 640, 663. Nowhere is this maxim more clear than in California wage and hour litigation because employers must navigate a minefield of regulatory requirements under both federal and state law. Most significantly, the

California Labor Code regulates nearly all facets of employee compensation: the hours an employee works (*see, e.g.*, Cal. Lab. Code § 510), the hourly compensation an employee receives (*see, e.g., id.* § 1182.12), the frequency and length of required breaks throughout the workday (*id.* § 512), compensation for overtime (*id.* § 510), when employees must be paid (*see, e.g., id.* § 204), and even the information that must be provided to employees when they are paid (*id.* § 226). In addition, the Federal Labor Standards Act imposes similar regulations under federal law. (*See* 29 U.S.C. §§ 201 *et seq.*) As a result, employers routinely face costly and time-consuming litigation for alleged violations of one or more of these state or federal regulations. (Norton Rose Fullbright, *2016 Litigation Trends Annual Survey* (Sept. 2016) at 10 (noting that 46% of respondents in the United States indicated they had a labor and employment lawsuit pending in the prior twelve months).) The decision in *Goonewardene*, however, extends to payroll service providers the litigation risks associated with wage disputes and claims traditionally asserted against employers for violations of state and federal wage and hour laws.

A. *Goonewardene* Exposes Payroll Service Providers To Staggering Defense Costs For Wage And Hour Violations Without Providing Any Added Benefit To Employees.

Labor and employment class action litigation “has increased [] over the past decade,” and wage and hour class actions in particular are “the leading type of ‘high stakes’ lawsuits being pursued by the plaintiffs’ bar.” (Seyfarth Shaw LLP, *13th Annual Workplace Class Action Litigation Report*, 2017 Edition, at 1-2.) California leads the way in this regard, and “[t]he most dominant trend has been a steep rise in the number of class action lawsuits filed in state courts alleging violations of California’s overtime laws or the California Labor Code and wage & hour regulations.” (*Id.* at 445.) Worse still, the costs of wage and hour lawsuits have been increasing dramatically year over year. (Seyfarth Shaw LLP, *13th Annual Workplace Class Action Litigation Report*, 2017 Edition, at 34 (top ten private plaintiff settlements for wage and hour lawsuits rose from \$215 million in 2014 to \$463.6 million in 2015 to \$695.5 million in 2016).)

As with all litigation, defending wage and hour claims can be extremely expensive. The cost of defending and prosecuting large wage and hour class actions oftentimes can be in the millions of dollars. *See Laffitte v. Robert Half Int’l, Inc.* (2016) 1 Cal. 5th 480,

487 (plaintiffs' attorneys collectively billed more than 4,000 hours resulting in approximately \$3 million in fees). Unlike most claims, however, Labor Code violations typically permit an employee to recover their attorneys' fees. *See, e.g.*, Cal. Lab. Code §§ 218.5, 226(e), 226(h), 233(e), 1194, 2699(g). Many of these are one-way fees shifting provisions, which further increases an employer's costs of wage and hour litigation. *See, e.g., id.* § 2699(g) ("Any *employee* who prevails in any action shall be entitled to an award of reasonable attorney's fees and costs.").

Goonewardene exacerbates this problem by extending these potentially crippling defense costs to payroll service providers while confusing the fact that the employer obligations in question are *non-delegable* and thus should not be visited upon a third party (such as the payroll service provider) which has no direct relationship with the employees. Under *Goonewardene*, employees will continue to sue their employers in addition to suing payroll service providers, because the employees cannot obtain complete relief from payroll service providers since such providers are not their employers. Such a result not only confuses the employment obligations among the parties, it

places a huge financial burden on a third party who has no control over the circumstances and environment of employment.

The myriad provisions of the California Labor Code do not apply to payroll service providers because payroll service providers are not “employers” under the Code. *Futrell v. Payday California, Inc.* (2010) 190 Cal. App. 4th 1419, 1428. Thus the only damages theoretically available to employees under *Goonewardene* are unpaid wages that the payroll service provider allegedly was contractually obligated to make. Employees therefore have a strong incentive under *Goonewardene* to sue payroll service providers as well as their employer because unlike a payroll service provider, “an employer is potentially liable for unpaid wages and interest, statutory penalties and civil penalties for many violations of Labor Code wage-and-hour provisions.” *Caliber Bodyworks, Inc. v. Superior Court* (2005) 134 Cal. App. 4th 365, 378.

Allowing employees to seek relief directly from payroll service providers merely makes wage and hour litigation extremely inefficient and misdirects attention to the payroll provider rather than the employer itself. Employees cannot obtain any relief from payroll service providers that they could not obtain directly from their

employers through the traditional wage and hour enforcement mechanisms established by the Legislature. *Goonewardene* significantly increases the costs of litigating wage and hour claims without providing any added benefit to employees. To the contrary, extending potential liability to payroll service providers will likely result in more protracted and complex litigation which would only increase defense costs for all parties and delay any recovery by employees.

B. *Goonewardene* Exposes Payroll Service Providers To Staggering Damages Claims For Wage And Hour Violations Without Providing Any Added Benefit To Employees.

Incurring unnecessary defense costs is merely the tip of the iceberg – the potential damages payroll service providers could face under *Goonewardene* is disastrous. The size and scope of wage and hour lawsuits have been increasing dramatically year over year: the top ten private plaintiff settlements for wage and hour lawsuits rose from \$215 million in 2014 to \$463.6 million in 2015 to \$695.5 million in 2016. (Seyfarth Shaw LLP, *13th Annual Workplace Class Action Litigation Report*, 2017 Edition, at 34.)

Even when limited to wages due, the damages in a wage and hour lawsuit can be massive. For example, in *Alexander v. FedEx*

Ground Packaging System, Inc., more than \$21 million of the settlement amount was for unpaid wages. (Settlement Agreement, *Alexander v. FedEx Ground Packaging System, Inc.* (N.D. Cal. Sept. 11, 2015) Case No. 3:05-CV-38-EMC at 13.)⁵ Under the California Labor Code, only an employer is responsible for paying employee wages, and thus a payroll service provider should have no obligation to pay any damages for unpaid wages to the employee. *Futrell, supra* 190 Cal. App. 4th at 1428. Nonetheless, under *Goonewardene*, payroll service providers could be liable to employees for their unpaid wages. Payroll service providers forced to pay damages for unpaid wages may be able to recover their damages payments from the responsible employer, but only after incurring additional litigation expenses for bringing indemnification claims. Thus, under *Goonewardene*, payroll service providers' clients each bring an unforeseen and inescapable risk that the payroll service provider may incur millions of dollars defending a wage and hour lawsuit brought by the client's employees, may face multi-million dollar judgments to

⁵ The Settlement Agreement is available on PACER and at [https://alexander-v-fedexground-settlement.com/Portals/0/Documents/2015%200915%20EXH%201%20\(Settlement%20Agreement%20with%20signatures\).pdf](https://alexander-v-fedexground-settlement.com/Portals/0/Documents/2015%200915%20EXH%201%20(Settlement%20Agreement%20with%20signatures).pdf)

the client's employees for unpaid wages, and additional litigation expenses to obtain indemnification from the client – none of which benefits the employees who already can seek their unpaid wages from their employer. Indeed, such a result only confuses the true *non-delegable* duties an employer has to its employees.

III. GOONEWARDENE WILL DISTORT THE ECONOMICS OF PAYROLL SERVICES AND WILL ADVERSELY IMPACT THE PAYROLL SERVICE PROVIDER INDUSTRY AND COUNTLESS CALIFORNIA EMPLOYERS WHO RELY ON THESE SERVICES.

The decision in *Goonewardene* will significantly alter the legal landscape for wage and hour litigation in California and will have a devastating impact on the payroll provider industry to the detriment of countless California employers and workers. More specifically, *Goonewardene*: (1) will increase prices for payroll provider services to reflect the added litigation risks and costs of defending wage and hour lawsuits, potentially making such services cost-prohibitive to many California employers; (2) will lead to employers' loss of access to payroll provider services, resulting in less compliance and weakened protections for workers; and (3) will produce unnecessary confusion as to the obligations between employers, employees and third party payroll service providers.

A. The Pricing of Payroll Provider Services Will Increase To Reflect The Added Litigation Risks Potentially Making Such Services Cost-Prohibitive To California Employers.

As more fully set forth above, the ruling in *Goonewardene* will significantly increase a payroll service provider's risk of incurring massive litigation costs. This change in the legal landscape will necessarily increase the costs of payroll provider services, potentially making such services cost-prohibitive for many California employers. In addition, the increased litigation risk and massive defense costs may prove insurmountable to many payroll service providers who may choose, or may be forced, to leave the California market altogether.

Payroll service providers currently offer employers cost-effective tools and services that facilitate an employer's compliance with federal and state labor laws. (*See* Paychex, Inc. Form 10-K (May 31, 2016) at 3 (“Our . . . tools, can assist companies with the scheduling, tracking and reporting of time which can be beneficial to clients in complying with [labor laws]”).) The price of these tools and services is a key factor in determining whether an employer will engage a payroll service provider in the first place and, once engaged, whether they will opt for a competing payroll service provider who

offers a more cost-effective option. (*Id.* at 6.) Although the cost of payroll services varies, the pricing structure typically involves a flat base fee that is charged per month or per pay period and added costs for more advanced services. (Paychex, Inc. Form 10-K (May 31, 2016) at 2; *see* Hoover's Inc., *Payroll Services First Research Custom Report*, (2017) at 4.) For example, Paychex charges recurring fees for services performed that are driven by various factors, including the number of transactions per client per pay period and whether the client uses any ancillary products. (Paychex, Inc. Form 10-K (May 31, 2016) at 2.) The competitive nature of the industry provides employers with a variety of options to choose from. In fact, payroll service providers have an incentive to offer increasingly flexible products and systems that allow different employers to use different aspects of those systems to varying degrees, depending on the employer's diverse needs and budget. The pricing of payroll provider services, however, also reflects the risks inherent in the industry. (*See* Paychex, Inc. Form 10-K (May 31, 2016) at 7.) Changes in laws and regulations that result in increased risks will necessarily increase the cost of these services.

The ruling in *Goonewardene* will significantly increase the litigation risk and defense costs for payroll service providers which will, in turn, significantly increase the cost of these services. For example, consider a company in Los Angeles with ten employees that uses a payroll service provider that charges a flat fee of \$100 per month and an additional \$5 per employee per pay period to process the company's bi-weekly payroll. (See The Payroll Blog, ("While base account fees vary widely from one provider to the next, you can expect to pay anywhere from \$20 to \$100 per month, plus an additional \$1.50-\$5.00 per payroll run for each employee."))⁶ On average, the company pays \$20 for each employee to process their payroll [\$5 each for the two pay periods plus the pro-rata share of the \$100 monthly flat fee]. Assume one of the company's employees sues the payroll service provider alleging that the employee was misclassified as falling within the "Executive Exemption" and therefore was entitled to be paid overtime and entitled to rest and meal breaks none of which she received. (See e.g. Wage Order 4 § 1(A)(1); Cal. Lab. Code §§ 510, 512, 515.) The \$435 filing fee the payroll

⁶ Available at: <https://www.surepayroll.com/resources/blog/small-business-payroll-cost>