

Case No. S238941

**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

PETITIONERS' OPENING BRIEF ON THE MERITS

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I. STATEMENT OF ISSUES¹

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 nondelegable?

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' nondelegable 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

¹ The Court's order granting review did not modify or restate the issues.

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?

II. INTRODUCTION

California employers for more than 60 years have engaged individuals and businesses to assist them with their nondelegable obligation to properly pay their employees. The demand by employers for assistance with their payroll obligations has resulted in the creation of a huge industry to provide payroll services to employers. Petitioner ADP, LLC is one of the many businesses that provides payroll services to thousands of California employers.

Until the court of appeal decision here, how a California employee challenged an allegedly improper wage payment—whether or not a payroll service provider had been engaged by the employer—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's claim had no merit, the claim terminated. If the employee's claim had merit, 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 the recourse available to the employer if an error by the payroll service provider 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 with arguments that payroll service providers are employers or coemployers 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. Op.-12-20.²

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 intended 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, if upheld, will mean that payroll service providers routinely will become defendants in pending and future wage-and-hour lawsuits simply because they assisted employers in discharging their nondelegable duties to pay wages. Because thousands of wage-and-hour lawsuits are filed annually in California, payroll service providers will incur crushing litigation

² The court of appeal's November 4 opinion is cited "Op.-__" and the November 29 modification as "M-Op.-__." Plaintiff-Appellant's court of appeal appendix is cited "[vol]AA-__." Respondents' one volume appendix is cited "RA-__." Emphasis is added in quoted material except where indicated.

expenses that will upend the economics of their industry, inevitably put some payroll service providers out of business, and raise the cost of their services to employers.

It is also no exaggeration to say that this extraordinary change in California law to add another defendant to wage-and-hour lawsuits will complicate and delay those lawsuits and increase the expenditure of time and money by all the parties and by the trial courts, with no compensating benefit for anyone. The purpose of wage-and-hour litigation is to adjudicate whether an employee was properly paid. The court of appeal's newly-recognized causes of action against payroll service providers are redundant to the claims the Labor Code and the employment relationship make available to employees to ensure that wages are properly paid. Worse still, by recognizing two tort claims against payroll service providers that are unavailable to employees against their employers under the Labor Code, the 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. Moreover, recognition of direct claims by employees against their employers' payroll service providers will cause a circularity of litigation, since any payroll service provider found liable for wages inevitably will bring a claim back against the employer for indemnification or contribution.

As detailed here, the Court should hold that employees are not third-party beneficiaries of contracts between their employers and payroll service providers. Such a holding follows from the nondelegable nature of wage-and-hour law duties that fall on employers and subject them to the comprehensive and exclusive remedies created by the

Legislature. It also follows from application of each of the different tests used to identify third-party contract beneficiaries. Employees are not third-party beneficiaries because payroll service providers do not discharge employers' nondelegable wage-and-hour obligations, such contracts do not display a clear intent to benefit employees or allow them independent powers of enforcement, and the principal purpose of such contracts is to assist employers in fulfilling their wage-and-hour obligations, not benefit employees. The Court need go no further than this in addressing issues concerning third-party beneficiary contracts.

Nevertheless, the case provides the Court with an opportunity to refine the standards used to identify third-party beneficiaries given the widely held view that current standards are vague and unpredictable. Thus, the Court could consider adjusting the standards for identifying third-party beneficiaries to focus on: (a) whether contracting parties expressly conferred enforcement rights on third parties; (b) whether third-party enforcement rights are necessary to effectuate the contracting parties' performance objectives; and/or (c) whether Plaintiff's allegations are sufficient to allow intelligent application of the standards for identifying third-party beneficiary contracts.

Whether the Court applies existing case law, or refines the standards for identifying third-party beneficiary contracts, Plaintiff here has no third-party beneficiary rights based on her employer's contract for payroll preparation assistance.

Turning to the tort claims at issue, the Court should hold that employees may not sue their employer's payroll service providers on causes of action for professional negligence or negligent misrepresentation based on alleged errors in paychecks or wage

statements. The court of appeal allowed these tort causes of action based on its erroneous classification of employees as third-party beneficiaries. Once that error is corrected, the basis for recognizing negligence claims disappears.

However, tort liability is unwarranted in any event. This Court's precedents disapprove of claims in tort that overlap with contract obligations or seek recovery for economic losses. Additionally, this Court's precedents for determining the existence of duties preclude recognizing either a professional negligence or negligent misrepresentation cause of action.

This Court should order that the trial court judgment be affirmed.

III. STATEMENT OF THE CASE

A. The Parties And The Payroll-Processing Industry

Plaintiff Sharmalee Goonewardene alleges she did travel-agent work for two employers named Altour, Inc.³ (1-AA-43, ¶¶7-8, 10, 46, 47 ¶¶26-28) Defendant ADP, LLC provided payroll-processing services to Altour. (1-AA-42, ¶¶4, 72, 187)

Payroll service providers assist employers in fulfilling their payroll obligations. While employment relationships are contractual,⁴ an array of federal and state laws apply to wage payments, working hours, paychecks, wage statements and tax withholding. Employers are responsible for complying with these "wage-and-hour" laws. They must

³ Altour allegedly comprises two corporations named Altour International, Inc. (one in New York; one in California) (2-AA-78-80, ¶¶14-32; 2-AA-89, ¶102)

⁴ *Turner v. Anheuser-Busch, Inc.* (1994) 7 Cal.4th 1238, 1252.

answer for noncompliance, even if they hire payroll service providers to assist them or to function in lieu of an in-house payroll department. *See, post*, topic IVA.

Under typical payroll-processing arrangements, the employer—“the party who hires the employee and benefits from the employee’s work”—sends to the payroll service provider “information about the [workers’] hours and rate[s] of pay”; paychecks and wage statements are then prepared using the information; completed paychecks and wage statements are either returned to the employer or distributed directly to workers.

Futrell v. Payday California, Inc. (2010) 190 Cal.App.4th 1419, 1432, citing in part *Singh v. 7-Eleven, Inc.* (N.D. Cal. Mar. 8, 2007, No. C-05-04534 RMW), 2007 WL 715488. “The preparation of payroll is largely a ministerial task, albeit a complex task in today’s market place.” *Futrell*, 190 Cal.App.4th at 1432.

Thousands of California employers make widespread use of payroll-processing services. Hundreds of entities provide payroll-processing services, and range in size from small enterprises, with few employees, to large firms with hundreds of employees dedicated exclusively to serving those employing California workers.⁵

B. Plaintiff Sues Her Employer On Employment-Related Claims And Then Adds Claims Against Payroll Service Provider ADP

Goonewardene sued Altour in April 2012 alleging employment-related causes of action: failure to comply with Labor Code requirements governing hours of work and wage payments; wrongful termination; and racial discrimination. (1-AA-3)

⁵ The breadth and diversity of the payroll-processing service industry is described in the many letters submitted to this Court in support of granting review.

Two years later, Goonewardene amended to add Altour’s payroll-processing vendor—ADP, LLC—in a single cause of action under California’s Unfair Competition Law (UCL), Business & Professions Code §17200.⁶ ADP, LLC demurred. (1-AA-12) Goonewardene sought leave to file a Fifth Amended Complaint (“5AC”) and add as defendants AD Processing, LLC (the name under which ADP LLC does business in California) and ADP Payroll Services, Inc. (1-AA-37, 66 ¶1, 2-AA-76-77, ¶¶6-8) (collectively “ADP”). ADP opposed the proposed amendment. (1-AA-10)

C. The Trial Court Rejects Plaintiff’s Attempt To Blur Employer Duties To Fulfill Its Wage-And-Hour Compliance Obligations, But Allows Plaintiff Leave To Amend

The demurrer was sustained, and all allegations based on ADP, LLC’s status as Goonewardene’s alleged employer in the proposed 5AC were dismissed with prejudice. (RA-66, ¶¶3-5(f)) Nevertheless, the court let Goonewardene try to plead a claim based on a different theory. (*Id.*)

What followed was Goonewardene’s relaunched 5AC, which realleged various claims and added new ones against ADP:

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 (1-AA-12, 23; 2AA-97; RA-3) (ADP, LLC was added to the thirteenth cause of action of Goonewardene’s fourth amended complaint (“4AC”).)

6. aiding and abetting (19th cause of action).

(2-AA-97-103)

The 5AC also doubled-down on Plaintiff's already-rejected theory that the ADP defendants were Plaintiff's employer, alleging all of Goonewardene's employment-related claims against newly-added defendants AD Processing, LLC and ADP Payroll Services, Inc. (2-AA-84-97) Unsurprisingly, the court again sustained ADP's demurrer to these claims because payroll service providers do not employ their customers' workers. (1-AA-27)

As to Plaintiff's newly-added causes of action, ADP's demurrer was sustained without leave to amend in a thoughtful and detailed order. (1-AA-33-34)

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 "nondelegable."

1-AA-33:19-27.

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.⁷ (1-AA-37; 40). The trial court did not rule

⁷ As to ADP, the 6AC added new allegations—they are underscored—in paragraphs 139-157, 160, 162, 170-171 and 184-186. (1-AA-64-68, 72)

on Plaintiff's reconsideration motion. Judgment was entered on August 5, 2015. (1-AA-25)

D. The Court Of Appeal Holds That Employees May Not Sue Their Employers' Payroll Service Providers For Wage-And-Hour-Related Violations Of The Labor Code And IWC Wage Orders

On appeal, Plaintiff did not defend the sufficiency of the 5AC. Op.-6-7. Rather, the court of appeal considered whether the proposed 6AC stated any cause of action. Op.-7-8. The 6AC alleged (unchanged from the 5AC) that ADP should be liable for various Labor Code violations. Op.-13.⁸

The court of appeal held that ADP could not be liable for violating the Labor Code (or applicable IWC Wage Orders) because ADP was not Plaintiff's employer. The court endorsed the analysis of *Futrell*, 190 Cal.App.4th at 1432, 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 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 statutes.”

⁸ While the 6AC alleged causes of action for failure to provide Plaintiff with required meal and rest breaks, ADP was not named as a defendant as to them. 1-AA 51 However, Plaintiff sought to hold ADP liable for delayed and underpaid wages based on any failure to pay Plaintiff the amounts envisioned under Labor Code §226.7 when breaks are not provided. 1-AA 68

Op.-15.⁹

E. The Court Of Appeal Holds That Employees May Redress Employer Violations Of Labor Code And Wage Order Duties By Suing Payroll Service Providers As Third-Party Beneficiaries Of The Contracts Under Which Payroll Service Providers Assist Employers With Payroll

What the court of appeal denied to Plaintiff with one hand it awarded to Plaintiff with the other. The court imposed on payroll service providers liability for violations of the same Labor Code and Wage Order duties that apply only to employers and do not authorize causes of action against payroll service providers.

Reviewing Plaintiff's "prolix and poorly organized 6AC," Op.-9, fn.3, the court classified Goonewardene as a third-party creditor beneficiary of the alleged unwritten contract by which Altour procured ADP's assistance with its payroll. Op.-23. The court relied on the third-party beneficiary contract framework set out in the First Restatement of Contracts and applied by this Court in *Martinez v. Socoma Companies, Inc.* (1974) 11 Cal.3d 394, 400. This framework divides into three groups those third parties who would benefit from the performance of a contract entered into by others: creditor, donee, and incidental beneficiaries. Incidental beneficiaries are not third-party beneficiaries. They may not sue to enforce the contracts of others even though they benefit by performance. *Bancomer, S.A. v. Superior Court* (1996) 44 Cal.App.4th 1450, 1458. "Creditor" and "donee" beneficiaries can enforce as third-party beneficiaries. "A person cannot be a creditor beneficiary unless the promisor's performance of the contract will discharge

⁹ For similar reasons, the court held that ADP could not be sued on claims for employment discrimination, wrongful termination, Op.-20-22, or failure to pay overtime compensation in violation of federal law. Op.-19-20.

some form of legal duty owed to the beneficiary by the promisee.” Op.-23, quoting *Martinez*, 11 Cal.3d at 400. “A person is a donee beneficiary only if the promisee’s contractual intent is either to make a gift to [the third-party beneficiary] or to confer on him a right against the promisor.” *Id.* at 400-401.

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. According to the court, the 6AC 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 opening brief 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.” (Court of Appeal-Appellant’s Opening Brief (“AOB”)-2)

Per the court, “the 6AC expressly attributed [to ADP] some of the alleged misconduct” that supposedly caused Plaintiff not to be fully compensated and to receive deficient wage statements. Op.-27. The court decided that “[t]he 6AC thus alleges that