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' REPLY BRIEF ON THE MERITS

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I. INTRODUCTION

The court of appeal decision disrupts the well-established and effective process by which California employees have long challenged allegedly improper wage payments. That decision also threatens the well-being of the payroll industry comprising the businesses that for more than 60 years have assisted employers with their payroll obligations. In conflict with California law and public policy, the court of appeal decision blurs distinctions between employer and payroll service provider responsibilities that—until now—imposed exclusively on employers the nondelegable duty to pay employee wages in the manner California law requires. The court of appeal confers no countervailing benefit to anyone in recognizing causes of action that for the first time would allow employees to bring direct actions against payroll service providers engaged by their employers. These new causes of action will result in employee claims that are redundant, inefficient and ultimately circular.

Petitioners' Opening Brief sets out in detail the reasons why the court of appeal decision must be reversed. Plaintiff's meandering and confusing opposition provides no persuasive support for a different outcome. Rather, it illustrates that the decision, if left to stand, will encourage future plaintiffs to argue for even broader (but still redundant, inefficient and circular) direct claims by employees against payroll service providers and ultimately against anyone engaged by an employer to perform services that arguably benefit an employee. In this brief, we refute Plaintiff's arguments (as best we can understand them) and again demonstrate why the decision is wrong and

injurious to the system the Legislature has established to ensure that employee wages are paid promptly and properly.

One noteworthy omission from Plaintiff's brief is a disclosure about the status of her trial court suit against her employer. The trial court has found—following trial—that Plaintiff's claim against her employer (Altour International, Inc.) for "off the clock" work fails because Plaintiff worked remotely, was responsible for reporting her hours worked, and "did not tell anyone at Altour she was working off the clock."[1] With respect to Plaintiff's claim for unpaid overtime, the trial court found:

> Every witness who testified at trial, including Plaintiff herself, confirmed that she regularly did not timely report her overtime. She turned in timesheets weeks, and, at times, months after she performed the work. This created what can only be interpreted as an administrative nightmare, with overtime payments spread out over multiple paychecks. Documentary and testimonial evidence show that Defendants acted reasonably and responsibly in paying overtime. Plaintiff did not offer competent evidence that would establish a specific amount that she is actually owed. An audit of her timesheets against her actual payments, which are both in evidence, indicates errors in payment amounting to $6,143.76. This accounts for all overtime worked at 'double time' rates. Plaintiff is entitled to this amount. This relatively small underpayment was not willful or intentional.[2]

This ruling demonstrates that the existing process for resolving wage payment claims works. That process should not be disrupted by the addition of pointless claims against payroll service providers. This ruling vividly illustrates how payroll service

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[1] *See* Judge Ross Klein's April 19, 2017 ruling, attached to the accompanying Request For Judicial Notice.

[2] A claim for retaliation against Altour remains for trial (in September, 2017). ADP could have no involvement with such a claim.

providers are heavily dependent on the quality and accuracy of data supplied to them by employer-clients and their employees. And this ruling confirms the need for cautious judicial scrutiny when considering whether to create new causes of action, whereby employees may directly sue payroll service providers, based on one plaintiff's grandiose, unsubstantiated allegations.

II. WORKABLE AND PREDICTABLE STANDARDS ARE NEEDED TO IDENTIFY THIRD-PARTY BENEFICIARY CONTRACTS; PLAINTIFF OFFERS NONE

California cases describe third-party creditor beneficiary contracts as those where the contracting parties *expressly intend to benefit* a third party. *See, e.g.*, *Martinez v. Socoma Companies, Inc.* (1974) 11 Cal.3d 394, 400. But courts need to clarify how the express intent to benefit test should be applied. Clarity and predictability need to be brought to identifying true third-party beneficiary contracts and differentiating them from contracts that incidentally benefit third parties and, therefore, do not have third-party beneficiary status.

Plaintiff's broad and enthusiastic embrace of the intent to benefit test (without change or clarification) confirms the need for a different approach in applying that test. Plaintiff unabashedly claims that the necessary intent to benefit is essentially automatic, *i.e.*, those who reap benefits from contract performance qualify as third-party beneficiaries whenever those benefits foreseeably result from contract performance.

The overbreadth of Plaintiff's suggested analysis is plain. According to her, "[a]ny agreement between [the payroll provider] and [employer] must involve

preparing earnings statements *for employees*." RB–7[3] (emphasis original). Plaintiff reasons "that the parties are presumed to intend the consequences of the performance of the contract, *Johnson v. Holmes Tuttle Lincoln-Merc.* (1958) 160 Cal.App.2d 290, 297, [meaning] it is clear that the intent in this case [of the ADP-Altour contract] includes providing Plaintiff and her co-workers with the benefit of accurate wage statements and properly calculated pay." RB–6; *see also*, RB–9 ("Altour employed ADP to provide earnings statements and wage calculations for Altour employees; therefore Altour intended that its employees would receive this benefit.") The benefit Plaintiff envisions for Altour employees is entirely derivative of the benefit Altour derives: "any company benefits from paying its employees in a manner required by law and the intention necessarily includes providing benefits to employees." RB–8.

Thus, Plaintiff would find the express intent to benefit Altour employees—thereby creating a third-party creditor beneficiary contract—from nothing more than ADP "realiz[ing] that Altour is required by law to compensate employees for their labor, and to provide earnings statements." RB–8. Indeed, Plaintiff goes so far as to assert that "third-party beneficiary law does not require an express intent to benefit in California." RB–10. That statement is directly contrary to California precedent that even the court of appeal applied. *See* Op.-22; citing Civil Code §1559 ("[a] contract, *made expressly for the benefit* of a third person..."); Op.-23 (plaintiff "must plead a

[3] ADP adheres to the citation conventions used in Petitioners' Opening Brief ("AOB–[CITE]"). In addition to those contentions, Respondent's Opposition Brief is cited "RB–[CITE]."

contract was *made expressly for his benefit*.... (*Luis v. Orcutt Town Water Co.* (1962) 204 Cal.App.2d 433, 441")).[4]

"A broad grant of power to claim under the contract to everyone who could show that he would have benefitted by a performance, and hence had lost by a breach would have made a shambles of the law." A. Mueller and A. Rosett CONTRACT LAW AND ITS APPLICATION 498 (1971). Plaintiff's proposed standard for finding "express intent to benefit" must fail because it does not differentiate between intended and incidental beneficiaries. As to both, contracting parties will usually foresee that their performance will benefit third parties.[5] "Courts need to look beyond the mere fact of the benefit itself; otherwise, anyone positively impacted by the contract could pursue a claim." Geis, *supra*, at 1165.

Allowing claims to anyone affected by contract performance would undermine the certainty and predictability that lie at the root of contract law. When over-inclusive or unpredictable standards are used by courts, contracting parties face an

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[4] While some have suggested that "express" intent to benefit may be proven other than by looking within the four corners of a contract, *see Neverkovec v. Fredericks* (1999) 74 Cal.App.4th 337, 349, the requirement of a contract "expressly made for the benefit of a third person" is codified and well-settled. Some have suggested the express intent requirement should be used more aggressively by courts to reduce arbitrary, unpredictable results when classifying third-party contract rights. See, e.g., G. Geis, BROADCAST CONTRACTING (2012) 106 Northwestern U. L. Rev. 1153, 1195; AOB–40-41.

[5] *See, e.g., Mariani v. Price Waterhouse* (1999) 70 Cal.App.4th 685, 701 (holding there is no express third-party beneficiary to a standard audit contract because "an exceptional degree of third-party impact is necessarily foreseeable in the contractual relationship for audit services" but conferring third-party beneficiary status would erase the distinction between incidental and express beneficiaries).

impaired ability to express their intent. Despite best efforts, contracting parties who set out to craft purely bilateral relationships can find themselves exposed to claims from—and responsibilities toward—persons with whom they did not contract, and as to whom they had no intent to confer either benefits or enforcement rights. "At its core...contract law seeks to facilitate the power of self-governing parties to further their own interests by contracting. Allowing enforcement of contracts by third-party beneficiaries often conflicts with those interests." M. Eisenberg (1992) THIRD PARTY BENEFICIARIES, 92 Colum. L. Rev. 1358, 1374.

Undue expansion of third-party beneficiary contract rights is also undesirable in this case because it will dilute and blur employer wage-and-hour obligations. Those important employer obligations should be subject to a rule of nondelegation, AOB–18-19, because that will promote responsibility and accountability by the only actors situated to assure compliance, namely, the employers who benefit from the employees' work. As to wage-and-hour law responsibilities, employers control rates of pay, hours worked and the methods by which payrolls are prepared. When engaged, payroll service providers depend on wage-and-hour data provided to them,[6] and employers remain responsible to government authorities for taxes and other remittances that must be withheld and disbursed from employee wages. See AOB–20 & n.18. Confirming a

[6] The results of Plaintiff's trial against her employer amply confirm this. The court found that Plaintiff did not submit to her employer on a timely basis accurate records of her hours worked. *See* accompanying RJN. A payroll service provider calculates payroll based on data received from employer-clients and their employees. If the data received is incorrect, the resulting payroll calculations will be in error, through no fault of the payroll service provider.

clear line of responsibility to employers avoids finger-pointing, cross-allegations, and other wrangling that can confuse and delay wage payments. Moreover, there is wisdom in retaining the current system that effectively settles employer-employee and employer-government payroll and tax remittance obligations *inter se*, while leaving employers with contract recourse against payroll service providers when necessary in appropriate cases.[7]

The court of appeal's analysis, and Plaintiff's expansive formulation of the express intent to benefit standard, should also be rejected because they circumvent the exclusive remedies the Legislature has codified. The Legislature is best able to evaluate whether broader liability will enhance compliance or, conversely, create purposeless claims and distractions that increase costs and delay resolution of wage disputes.

Plaintiff does not controvert that "the legal treatment of [third-party] beneficiaries is a major source of contention in contract law." AOB–39, quoting Geis, *supra*, at 1153. In its opening brief, ADP has detailed thoughtful concerns expressed by numerous commentators. In response, Plaintiff quibbles with ADP's reference to Professor Eisenberg's article because the article does not address payment of wages or third-party beneficiary cases involving that scenario. RB–9-10. But ADP is unaware

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[7] Apart from Plaintiff's dubious information-and-belief allegations as to an allegedly oral payroll service contract, there is nothing to suggest that existing rules governing wage-and-hour claims and liabilities have failed to redress misconduct such that a broadened class of additional defendants would better promote wage-and-hour enforcement.

of precedent predating the decision below where third-party beneficiary principles were invoked to impose liability on those hired to assist with an employer's payroll. This Court rejected use of third-party beneficiary principles to broaden wage-paying obligations beyond an employer—in *Martinez v. Combs* (2010) 49 Cal.4th 35, 49—because there was no source from which to depart from the general rule that employers—and not others—are responsible for the wages of those who work for them. In *Martinez*, the fact that others (not the employer) benefitted from the workers' labor was not invoked as a reason to give workers the right to pursue those who benefitted from their labor. *Id.* at 69. Moreover, Professor Eisenberg's concerns—and those of other scholars—are directed at contract law and the need for workable and predictable standards for identifying third-party beneficiary contracts generally, not just employment or payroll-processing contracts.

It is against this backdrop that this case needs to be decided.

III. AN EMPLOYER'S WAGE-PAYING DUTIES ARE NONDELEGABLE; STATUTORY REMEDIES ARE EXCLUSIVE; THESE ARE AMONG THE REASONS WHY EMPLOYEES ARE NOT THIRD-PARTY BENEFICIARIES OF THEIR EMPLOYERS' PAYROLL SERVICE CONTRACTS

Plaintiff does not controvert many points ADP has made concerning wage-and-hour laws and the obligations they assign to employers. She does not contest "the public policy in favor of requiring employers to comport with Labor Code wage statutes and promptly and fully pay their employees." *Aleksick v. 7-Eleven, Inc.* (2012) 205 Cal.App.4th 1176, 1180; AOB–18. She does not question the elaborate legislative scheme of wage-and-hour enforcement, with its repeated references to

mandatory, "shall" duties placed on employers. AOB–16-18. She does not dispute that the Legislature has selectively chosen to subject specific, non-employer actors to potential liability for wage-and-hour violations. AOB–18 & n.17. Nor does she dispute that the Legislature has never recognized potential wage-and-hour liabilities for payroll service providers.

A. Employer Wage-And-Hour Duties As To Overtime Pay And Wage Statements Should Not Be Delegable

One of ADP's many points is that duties to pay overtime wages and provide compliant wage statements should be viewed as nondelegable—and thus not a basis to create breach of contract or tort remedies against non-employers—because the Labor Code and the Wage Orders create the rights to overtime pay and wage statements, establish the remedies for violations, and largely limit those remedies to employers only. In part, Plaintiff stands silent. She does not dispute case law recognizing various situations where the holder of an important duty may not delegate it to an independent contractor, thereby to avoid or lessen personal liability. AOB–18. Nor does Plaintiff question that an employer's wage-paying duties are of such importance that they, too, should be viewed as nondelegable.

In further support of concluding that employer duties as to overtime wage payments and wage statement compliance are not delegable, ADP pointed out that remedies codified for overtime pay and wage statement noncompliance are exclusive such that the courts should not add to them. AOB–20-21. ADP invoked a rule Plaintiff acknowledges—without quarrel: "[a]s a general rule, where a statute creates

a right that did not exist at common law and provides a comprehensive and detailed remedial scheme for its enforcement, the statutory remedy is exclusive." *Rojo v. Kliger* (1990) 52 Cal.3d 65, 79.[8] ADP also invoked *Brewer v. Premier Golf Properties* (2008) 168 Cal.App.4th 1243, 1252, which describes remedies for Labor Code §226 pay statement violations as exclusive. Plaintiff cites *Brewer* without acknowledging its holding as to wage statements. RB–11. Instead, Plaintiff generally discusses the "new right/exclusive remedy doctrine," RB–11-12, claiming the exclusive remedies in the labor and employment domain involve worker's compensation claims. RB–12. Plaintiff also suggests that, as to her overtime and wage statement claims, codified remedies are not exclusive because employees could sue at common law for overtime and wage statement violations. Nonsense.

To be sure, worker's compensation claims are subject to a scheme of exclusive remedies, and these are administered in a special forum that largely functions outside the judicial system. But other Labor Code and Wage Order rights are also subject to exclusive, codified remedies. *Brewer*, *Rojo* and similar cases recognize that legislatively-created rights and enforcement schemes are presumptively exclusive if the rights at issue did not exist at common law. Plaintiff's overtime pay and wage statement claims involve such rights. Hence, judicially-created remedies would circumvent the Legislature's comprehensive and exclusive remedial scheme.

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[8] In its opening brief at AOB–20, ADP quoted this statement from *Rojo*, but mistakenly cited *Grodensky v. Artichoke Joe's Casino* (2009) 171 Cal.App.4th 1399, 1454 (review granted), which quotes the statement from *Rojo*. The intended citation was to *Rojo*.

B. Wage Statement Claims And Remedies Are Exclusive

Plaintiff questions whether Labor Code §226 provides the exclusive remedy for non-compliance with California's wage statement requirements. RB–12. But *Brewer* recognizes exclusivity, and Plaintiff fails to address this aspect of *Brewer*, 168 Cal.App.4th at 1252.

Plaintiff claims the tort of negligent misrepresentation was recognized before the Labor Code was codified. RB–13. Assuming that's true, it is irrelevant. There was no right to any particular form of wage statement before Section 226 was enacted. Moreover, Plaintiff cites no authority suggesting a claim for negligent misrepresentation was ever predicated on the form of a pay statement at any time before Section 226 was enacted.[9]

C. Overtime Pay Claims And Remedies Are Exclusive

Plaintiff asserts that an employee's right to receive accurately calculated wages predates the Labor Code. RB–12. Once again, assuming that's true, it is irrelevant. The right to overtime pay—as distinct from regular wages—is not a creation of contract or common law. *Earley v. Superior Court* (2000) 79 Cal.App.4th 1430, 1430 ("Entitlement to overtime compensation…is mandated by statute and is based on an important public policy.") Plaintiff's allegations relate to overtime pay, *i.e.*, she "was denied full compensation because ADP repeatedly failed to determine that she was owed overtime or double time pay, and otherwise provided inadequate earnings

[9] The decision below is the only case cited by either side that suggests an employee may have a negligent misrepresentation claim based on alleged errors on statements accompanying paychecks.

statements." Op.–27, 1-AA-48, ¶¶ 33; *id.* at 66-67, ¶¶ 147-48, 153; *id.* at 71, ¶ 180[10] In sum, the presumption of exclusive remedies is fully applicable.

Cortez v. Purolator Air Filtration Products Co. (2000) 23 Cal.4th 163, is not to the contrary. RB–12. *Cortez* recognized that claims for unpaid wages (including overtime) could be pursued via a UCL cause of action. That result is faithful to the exclusive remedies doctrine (though *Cortez* does not discuss the doctrine). Per *Cortez*, the Legislature effectively codified relief under the UCL as one of the exclusive remedies available to a plaintiff. *Cortez* did not create a judicial cause of action.

Lu v. Hawaiian Gardens Casino, Inc. (2010) 50 Cal.4th 592, 603, 604, RB–13, addresses an issue—not involved here—as to whether employees have a private right of action to enforce Labor Code §351, which prevents employers from taking, collecting, or receiving employee gratuities. *Id.* at 595-596. *Lu* predictably analyzes whether a statutory right carries with it a private cause of action for enforcement. In finding no private right of action, *Lu* noted that employees might be able to sue employers for conversion of their gratuities. *Id.* at 603-604. The right to receive wages (as distinguished from overtime pay or a wage statement) existed at common law. *See Earley*, 79 Cal.App.4th at 1430. So *Lu* does not undercut a conclusion here that Plaintiff's overtime and wage statement grievances are governed by exclusive

[10] As the court of appeal put it, alleged deficiencies in ADP's pay calculations relate to Plaintiff's "time cards [allegedly and] often containing facts requiring the payment of double time [she] did not receive...." Op.–31.

statutory remedies that should not be supplemented with judicially-created contract or tort claims against non-employers.

When, as here, the Legislature provides a comprehensive scheme to enforce overtime and wage-statement obligations—obligations the Legislature has not imposed on payroll service providers—courts must not create additional causes of action. That rule supports classifying employer wage-and-hour duties as not delegable: the Legislature defines those who may be sued for violations.

IV. A QUALIFYING, THIRD-PARTY CREDITOR BENEFICIARY CONTRACT DISCHARGES THE PROMISEE'S OBLIGATIONS TO THE THIRD-PARTY BENEFICIARY VIA THE PROMISOR'S PERFORMANCE; AN EMPLOYER'S PAYROLL SERVICE CONTRACT DOES NOT FULFILL THIS REQUIREMENT; IT CANNOT DISCHARGE THE EMPLOYER'S OBLIGATIONS TO ITS EMPLOYEES

Plaintiff is not properly classified as a third-party creditor beneficiary of the ADP-Altour payroll service contract because Plaintiff fails to satisfy each of several tests used to identify qualifying third-party creditor beneficiaries.

One defining characteristic of a third-party creditor beneficiary contract is that the promisor *discharges* obligations the promisee owes to a third party. That requirement applies here and defeats Plaintiff's third-party breach of contract cause of action. That requirement is not ADP's creation, RB–14. This Court recognized it in *Martinez*, 11 Cal.3d at 400:

> A person cannot be a creditor beneficiary unless the promisor's performance of the contract *would discharge* some form of legal duty owed to the beneficiary by the promisee.

This need for discharge of the promisee's obligation by the promisor's performance is also reflected in true third-party beneficiary situations where the promisor renders substitute performance or assumes full responsibility for performance—situations quite unlike that of the employer whose personal wage-and-hour law obligations remain in full force no matter how or by whom paychecks are prepared.

Plaintiff claims ADP's treatment of the discharge requirement involves "overly technical argument[s]" because "discharge" can include removing a burden such that, if ADP had "acted responsibly...it would have relieved Altour of the burden of the obligation..." to properly pay overtime wages to its employees via compliant wage statements. RB–14. But ADP cannot "discharge" an employer's duties to pay overtime wages owed and provide compliant wage statements. Those are nondelegable obligations. *See*, *ante*, topic III. As even Plaintiff concedes, "a principal may not assign nondelegable duties to an agent..." RB–21. The same applies to payroll service providers, whether they are viewed as agents or independent contractors of the wage-owing employers that contract with them. *See* AOB–19.

Plaintiff disputes application of the "discharge" or "substitute fulfillment" requirement when applied to employer wage-and-hour duties by claiming ADP cites no supporting authority and has therefore forfeited the argument. RB–14-15. But there is ample, cited authority. The Labor Code specifies (and limits) those who may be sued as defendants on Labor Code and Wage Order claims like those here.[11] In

[11] ADP noted recent legislative expansion of those who may be sued. *See* AOB–18 & n.17, citing Labor Code §§558.1, 1197(a). None of this expansion authorizes claims

Martinez, 49 Cal.4th at 35, AOB–16, this Court observed that "no generally applicable rule of law imposes on anyone other than an employer a duty to pay wages." *Id.* at 49.

The role of the "discharge" requirement as a principled way to differentiate third-party creditor beneficiary contract rights also finds support in precedent ADP has marshalled. It shows that third-party creditor beneficiary contracts are those where another person (the promisor) takes over the promisee's obligations to a third party, as for example in the debt repayment and lease assumption situations addressed by *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 Cal.2d 232, 244-245, and *Calhoun v. Downs* (1931) 211 Cal. 766, 770-771. *See* AOB–29. Plaintiff does not address this authority, just as she sidesteps the distinguishing characteristics of cases like *Soderberg v. McKinney* (1996) 44 Cal.App.4th 1760, 1771-1774, and *Del E. Webb Corp. v. Structured Materials Co.* (1981) 123 Cal.App.3d 593, 606-607, where promisors took full charge of promisee performance obligations and courts found intent to confer third-party beneficiary rights. Here, by contrast, payroll obligations remain at all times with the employer.

Plaintiff suggests that, as a fallback position, she is a third-party donee beneficiary of the ADP-Altour payroll services contract. RB–14. But Plaintiff does not develop an argument in support of that assertion. Nothing suggests that the Altour-ADP contract was intended to confer some sort of gift on Plaintiff.

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against service providers that assist employers—like ADP. And the Legislature's attention to changes in the remedies it has created is a strong reason why the courts should not venture beyond what the Legislature has sanctioned.

The discharge requirement of a third-party creditor beneficiary contract is not met by Plaintiff's allegations in this case.

V. A QUALIFYING THIRD-PARTY CREDITOR BENEFICIARY CONTRACT REQUIRES A CLEAR INTENT TO BENEFIT A THIRD PARTY; PLAINTIFF DOES NOT SATISFY THIS REQUIREMENT

Plaintiff does not dispute California precedent noting that the contracting parties' must express "clear intent" to benefit one or more third parties. AOB–32. This requirement is another way to bring workable and predictable standards to identifying third-party creditor beneficiary contracts and to differentiate them from contracts that incidentally benefit third parties.

The clear intent requirement is not satisfied here because Plaintiff's complaint offers only conclusory allegations with respect to the contracting parties' supposed intent to benefit Altour's employees. AOB–32, 42 & n.21. For example, Plaintiff invokes the following:

> Altour and ADP entered into an unwritten contract whereby ADP provided payroll calculation, records maintenance, 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.

RB–3. Such allegations do not state a factual basis for classifying Altour's employees as the specific, intended beneficiaries of an Altour-ADP payroll services contract. The allegations are, instead, consistent with Plaintiff's breathtakingly overbroad theory that a third-party creditor beneficiary contract is established because a consequence of ADP's performance for Altour is that benefits will derivatively flow to Altour