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PERSPECTIVE

## High court weighing liability of payroll-service providers

By Andy Y. Chen

The California Supreme Court case *Goonewardene (Sharmalee) v. ADP, LLC, et al.*, S238941, asks whether employees are third-party beneficiaries of their employers' contracts with payroll service-providers. Following nearly 50 minutes of oral argument last month, it remains unclear how broad a precedent the high court is willing to set for a payroll-service provider's duty to ensure accurate payment of wages for the average worker.

In April 2012, plaintiff Sharmalee Goonewardene sued her employer, Altour, Inc., alleging, inter alia, wage and hour-related Labor Code violations. Two years later, Goonewardene amended to add Altour's third-party payroll-service provider — ADP, LLC — in a single cause of action under California's Unfair Competition Law, Business and Professions Code Section 17200.6. The trial court sustained ADP's demurrer with leave to amend. Goonewardene subsequently alleged all of her employment-related claims and two new tort claims for professional negligence and negligent misrepresentation against ADP and its related entities. The trial court rejected Goonewardene's attempt to "blur the responsibility" between her employer and its PSP and sustained ADP's demurrer without leave to amend.

The 2nd District Court of Appeal affirmed in part that payroll-service providers cannot be liable under the Labor Code for improper wage payments since such wage and hour claims rest on statutory requirements imposed only on employers. *Goonewardene v. ADP, LLC*, 5 Cal. App. 5th 154, 167-68 (2016), citing *Futrell v. Payday California, Inc.*, 190 Cal. App. 4th 1419, 1432 (2010) (an employer's obligation to make sure its payroll checks are accurate and that its employees are properly paid their wages is non-delegable).

However, the Court of Appeal nevertheless reversed and ruled Altour employees were intended third-party creditor beneficiaries of the unwritten contract between Altour and ADP. Presiding Justice Nora M. Manella authored the unanimous opinion and rea-

soned that 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 creditor beneficiaries of the contract between the business and service provider. The Court of Appeal observed recognizing a duty of care would encourage accurate payment of wages and concluded ADP owed Altour employees a duty to prepare legally compliant paychecks and wage statements. The case was remanded with instructions to permit

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Goonewardene to file an amended complaint against ADP and its related entities for breach of contract, professional negligence, and negligent misrepresentation. On Feb. 15, 2016, the California Supreme Court unanimously granted ADP's petition for review.

On Dec. 5, 2018, counsel for ADP, Robert A. Lewis, argued in favor of the prevailing status quo where an aggrieved employee had well-established statutory remedies for challenging his or her employer for improper wage payments before the Division of Labor Standards Enforcement. However, Mr. Lewis encountered resistance almost immediately when he asserted ADP specifically and payroll-service providers more generally were merely creatures of contract immune from any liability. Chief Justice Tani G. Cantil-Sakauye acknowledged while the high court would not "rehash the issue" in *Futrell* that ADP may not be sued as Goonewardene's employer or joint employer, she questioned why liability shouldn't extend to ADP under the appellate court's third-party beneficiary theory, particularly since all elements were apparently satisfied: (1) the employee was likely to benefit from the contract, (2) the purpose of contracting

parties was to provide a benefit to the employee, and (3) it was consistent with the objectives and reasonable expectations of the contract or contracting parties to permit the enforcement action. When asked to identify why this was not a third-party beneficiary case, Mr. Lewis pointed out wage and hour-related duties are imposed by law on employers and absolutely non-delegable.

Associate Justice Goodwin H. Liu inquired whether payroll-service providers have any independent duty of any kind to understand whether or not the wage statements they give out to employees comply with the law. Mr. Lewis responded categorically: no, under California law payroll-service providers have no independent duty to employees to understand anything other than what's in the contract. Associate Justice Leandra R. Kruger posited whether the parties can theoretically authorize direct suit by the employee against the payroll-service provider as a matter of contract. Justice Liu interjected by posing a hypothetical: If an employee complains to the payroll-service provider about errors on the paystub, does the provider have an obligation to the employee to correct the error? Mr. Lewis deferred to the contractual language between the employer and the payroll-service providers. Justice Liu pressed further and continued the hypothetical: If the employer essentially ignores the situation and the employee brings suit, then until this wage and hour claim is ultimately resolved one way or another the payroll-service provider is free to "churn out possibly erroneous pay statements and there's no consequence to the payroll company while this is ongoing?" Mr. Lewis responded once more that it would depend on the service contract.

Justice Liu remained skeptical and questioned whether the payroll-service provider owes a tortious duty of care to behave reasonably towards the employee, perhaps at least alerting the employer of complaints received by employees. Mr. Lewis cautioned this would invariably lead to a slippery slope in which anyone who contracts with an employer for anything that arguably benefits an employee could be held liable, such as contracts for security, pri-

vacy, custodial or even courier services.

Associate Justice Mariano-Florentino Cuéllar probed the limits of Mr. Lewis' arguments in recognizing payroll is inextricably linked to a specific function that a payroll-service provider performs for the employer's employees. In other words, Justice Cuéllar seemed to recognize the employee's unique economic vulnerability and that from a public policy perspective, payroll should be considered distinct from the typical contractor/ subcontractor relationship. However, Associate Justice Carol A. Corrigan appeared to favor the status quo wherein the employer continues to bear any potential wage and hour penalties, but the employer may certainly turn around and sue the payroll-service provider: "Well [the current system] must work then!"

Counsel for Goonewardene, Glen Broemer, argued that the appellate court's analysis was logical and must stand: When an employer contracts a payroll-service provider to "take over the employer's payroll task, including the preparation of the payrolls themselves," the employees are considered third-party creditor beneficiaries of the contract. Mr. Broemer urged the justices to examine the Labor Code's policies and goals and to allow professional negligence claims against payroll-service provider given the high degree of skill and complexity required.

Whichever way the California Supreme Court decides will have monumental ramifications for the competitive and fragmented payroll-processing industry in California. Opinions are due within 90 days of the case's submission for decision, meaning a final ruling from the court will come by March 5, 2019.

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