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 ISSUES[1]

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

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[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

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[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)

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[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 statues."

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[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

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[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

Altour employees such as appellant are, at a minimum, third-party creditor beneficiaries of the unwritten [payroll services] agreement." Op.-26.[10]

F. The Court Of Appeal Holds That Employees May Also Redress Employer Violations Of Labor Code And Wage Order Duties By Suing Payroll Service Providers On Theories Of Professional Negligence And Negligent Misrepresentation

Viewing Plaintiff as a third-party creditor beneficiary of an unwritten contract between ADP and Altour, the court decided that ADP owed Altour employees a duty to prepare legally compliant paychecks and wage statements, the breach of which constitutes professional negligence. Op.-41. The court applied the factors outlined in *Biakanja v. Irving* (1958) 49 Cal.2d 647 and *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 376. Op.-41-42.

Similarly, based on Plaintiff's third-party beneficiary status, the court sanctioned suit against ADP for negligent misrepresentation based on Plaintiff's allegations that amounts paid to her and wage statements delivered to her were misleading when measured against wage-and-hour law requirements. 1-AA-66-67. Per the court, Plaintiff's allegations overcame the restriction that a negligent misrepresentation claim only lies against a professional service provider if the plaintiff is a "specifically intended

[10] 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.

beneficiary of the information supplied by the professional." Op.-31, citing *Murphy v. BDO Seidman* (2003) 113 Cal.App.4th 687, 694.[11]

G. The Modified Court of Appeal Opinion

Responding to ADP's rehearing petition, the court modified its opinion in two respects. First, it abandoned its holding that third-party creditor beneficiary status exists when "a contract with a service provider [is] clearly aimed at aiding the business in discharging its duty to supply information or benefits to certain individuals...." The court instead held: "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." M-Op.-1-2.

Second, the court rejected ADP's argument that the economic loss doctrine forecloses Plaintiff's negligence causes of action because they seek economic damages only. Without questioning the doctrine, the court declared it inapplicable because Plaintiff's status as a third-party creditor beneficiary created a "special relationship" between Plaintiff and ADP such that the economic loss doctrine would not apply to prohibit negligence causes of action that seek economic damages only. M-Op.-2-3.[12]

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

[12] While the court of appeal noted that ADP did not raise the economic loss doctrine until its rehearing petition, M-Op.-2, the court squarely addressed the doctrine's application to this case.

IV. ARGUMENT

The court of appeal correctly concluded—in a decision Plaintiff has not challenged via cross-petition—that the wage-and-hour duties at issue rest on Labor Code and IWC Wage Order requirements that are imposed on employers and do not apply to payroll service providers like ADP. But then the court erred by exposing payroll service providers to the very same wage-and-hour liabilities that apply to employers only, on the theory that payroll service providers are responsible to their customers' employees for wage-and-hour law noncompliance because they contracted to prepare payroll and wage statements.

This result blurs and dilutes employer wage-and-hour duties that are not delegable. Those duties apply only to employers, who are subject to liability not just to their employees, but also to state and federal authorities.

The court's decision to create wage-and-hour liabilities different from those promulgated in the Labor Code and in IWC Wage Orders cannot be reconciled with any of the various tests used to identify third-party beneficiary contracts. Worse still, subjecting payroll service providers to tort liability for employer wage-and-hour violations creates the perverse result that payroll service providers face greater potential liability than employers do, given the broader measure of damages available for tort claims. "[W]hen a statute imposes additional obligations on an underlying contractual relationship, a breach of the statutory obligation is a breach of contract that will not support tort damages beyond those contained in the statute." *Brewer v. Premier Gold*

Properties, LP (2008) 168 Cal.App.4th 1243, 1255 (principle applied to claims for unpaid wages and unprovided breaks).[13]

Applying California law, and taking public policy considerations into account, this Court should reverse the court of appeal decision with directions to affirm the trial court judgment.

A. Wage-And-Hour-Related Duties Are Imposed By Law On Employers And Not On Payroll Service Providers; Those Duties Are Nondelegable

"[N]o 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.

The Labor Code's statutory language repeatedly imposes duties on "employers." When the Legislature has wanted to broaden the class of those owing wage-and-hour compliance duties, it legislates, as it did by extending certain obligations to "an owner, director, officer or managing agent of the employer" who is a "natural person." Labor Code §558.1(a) & (b).[14]

Each type of wage-and-hour violation alleged by Plaintiff rests on a statutory or Wage Order requirement applicable to "employers." Each can be enforced by employees, the state, or on the state's behalf via private-party PAGA actions. Some violations expose employers to liabilities to the state: penalties and, in some cases, criminal sanctions. *See* Labor Code §203 (waiting time penalties); Labor Code §226.3

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[13] Labor Code and IWC Wage Orders impose requirements as to wage payments, hours worked, breaks and other matters that govern notwithstanding other employment contract terms. *Brewer*, 168 Cal.App.4th at 1255.

[14] Payroll service providers do not fit within any of these categories.

(penalties for wage statement violations); Labor Code §226.6 (misdemeanor liability for wage statement violations); Labor Code §553 (misdemeanor liability regarding working hour requirements); Labor Code §558 (civil penalties); Labor Code §2699, *et seq.* (PAGA scheme).

Overtime Pay. While overtime pay premiums are envisioned by Labor Code §§510 and 1194, overtime pay obligations are imposed by IWC Wage Orders. *Martinez*, 49 Cal.4th at 49. IWC Order No. 4-2001 applies to travel-agency work,[15] and that fits Plaintiff's allegations about her job at Altour. 1-AA-46, ¶26. Wage Order 4.2001(A)(3)(1) provides that those "employed" in excess of certain hours are entitled to premium pay. In construing similar Wage Order language, this Court deemed it applicable to employers. *Martinez*, 49 Cal.4th at 49.[16]

Wage Statements. Labor Code §226(a) provides that "[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...." Meal and rest break obligations are imposed on "employers" who must pay an additional hour of compensation for each day when a break is missed. Labor Code §227(a)&(b).

Other Labor Code provisions impose obligations on "employers." 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

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[15] *See* Wage Order 4-2001(2)(O), is found at 8 CCR §11040.

[16] The conclusion would be no different under the other Wage Order Plaintiff mentions, IWC Order No. 9-2001. It can be found at 8 CCR §11090. Its relevant provisions are similar to those in No. 4-2001.

§204(a)&(c); *see also* "employer" references in Labor Code §§201, 203 & 203.1. Throughout the Labor Code, "shall" is mandatory. Labor Code §15. When courts have considered extending liabilities for wage-and-hour violations beyond "employers," they evaluate issues like 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.[17]

These principles have contributed to the uniform view—adopted by the court of appeal here—that payroll service providers may not be sued on claims that their customer's employees were not paid according to wage-and-hour law requirements. *Futrell*, 190 Cal.App.4th at 1419.

That outcome is consistent with "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.

When an employer hires a payroll service provider to assist with or even "take over" wage-and-hour functions, that does not shift employer compliance responsibilities elsewhere. "There are numerous considerations which have led courts to depart from the rule of nonliability of a private employer for the torts of an independent contractor. Some of the principal ones are that the enterprise, notwithstanding the employment of the independent contractor, remains the employer's because he is the party primarily to be benefited by it, that he selects the contractor, is free to insist upon one who is financially

[17] As noted earlier, there are occasions when the Legislature affirmatively extends liability beyond employers, Labor Code §558.1, or penalizes those associated with certain violations (without subjecting them to an employer's wage-paying liability). Labor Code §1197(a).

responsible, and to demand indemnity from him, that the insurance necessary to distribute the risk is properly a cost of the employer's business and that the performance of the duty of care is of great importance to the public." *Van Arsdale v. Hollinger* (1968) 68 Cal.2d 245, 253. "Such nondelegable duties derive from statutes (*Maloney v. Rath, supra*, 69 Cal.2d at p. 448); contracts (*Harold A. Newman Co. v. Nero* (1973) 31 Cal.App.3d 490, 496-497, *Capitol Chevrolet Co., supra*, 227 F.2d at p. 173), and common law precedents (*Maloney, supra*, 69 Cal.2d at p. 447). Courts have held a party owing such a duty cannot escape liability for its breach simply by hiring an independent contractor to perform it. (*Maloney v. Rath, supra*, 69 Cal.2d at pp. 446-447; 6 Witkin, SUMMARY OF CAL. LAW, *supra*, Torts, §1017; Prosser & Keeton, *supra*, at pp. 511-512.)" *Barry v. Raskov* (1991) 232 Cal.App.3d 447, 455 (Opinion of Johnson, J.).

When the nondelegable duty doctrine applies, the employer is responsible for negligence by an independent contractor in relation to the nondelegable subject matter. It helps "assure that when a negligently-caused harm occurs, the injured party will be compensated by the person whose activity caused the harm and who may therefore properly be held liable for the negligence of his agent, whether his agent was an employee or an independent contractor." *Maloney v. Rath* (1968) 69 Cal.2d 442, 446 (Traynor, J.); *see also Alber v. Owens* (1967) 66 Cal.2d 790, 792 (employer cannot delegate workplace safety requirements by hiring independent contractors to satisfy them).

An employer's wage-and-hour compliance duties are comparable to those types of obligations that have been declared nondelegable. "The wages an employer owes its

employees are accorded 'a special status' under California law. Full and prompt payment of wages due an employee 'is a fundamental public policy of this state.'" *Davis v. Farmers Ins. Exchange* (2016) 245 Cal.App.4th 1302, 1331, quoting in part *Kerr's Catering Service v. Department of Industrial Relations* (1962) 57 Cal.2d 319, 325 and *Gould v. Maryland Sound Industries, Inc.* (1995) 31 Cal.App.4th 1137, 1147. Governmental bodies have also warned employers that their use of payroll-processing services does not relieve them of their obligations to pay, withhold and remit required payments, even when relying on others to perform those tasks.[18] A nondelegable duty situation suggest that the contracting parties did not intend to create third-party beneficiary rights. *See West v. Guy F. Atkinson Construction Co.* (1967) 251 Cal.App.2d 296, 302.

The nondelegable nature of wage-and-hour obligations is also reflected in the exclusivity of the remedies codified by the Legislature. "[W]here 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." *Grodensky v. Artichoke Joe's Casino* (2009) 171 Cal.App.4th 1399, 1454; *Brewer*, 168 Cal.App.4th at 1252 (Labor Code provides exclusive remedy for wage-and-hour violations). Recognition of third-party beneficiary or tort claims to extend wage-and-hour liabilities beyond those envisioned by the Legislature would impermissibly circumvent the exclusive rights and

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[18] *See, e.g.*, Internal Revenue Service, Outsourcing Payroll Duties, https://www.irs.gov/businesses/small-businesses-self-employed/outsourcing-payroll-duties (despite outsourced payroll processing "[t]he employer is ultimately responsible for the deposit and payment of federal tax liabilities")

remedies provided for alleged overtime, rest period, wage statement claims. *Id.* at 1253-1254.

B. Employees Are Not Third-Party Beneficiaries Of Their Employers' Contracts With Payroll Service Providers

A payroll service provider's contract with an employer to assist in fulfilling wage-and-hour law obligations should not confer on the employer's workers a right to enforce or sue for breach. The employees are not properly classified as third-party beneficiaries. That conclusion follows by applying each methodology courts have used to decide if a contract bestows third-party enforcement rights on persons not in privity. Although the Court need go no further, this case gives the Court an opportunity to examine and clarify a subject that has generated recurring confusion and uncertainty: how courts should determine whether a third party may sue to enforce a contract made by others.

1. Third-Party Contract Enforcement Rights

Judicial attitudes about third-party contract enforcement rights have evolved from outright rejection, *National Bank v. Grand Lodge* (1878) 98 U.S. 123, to conditional recognition. But courts and commentators have struggled to create a predictable and satisfying test for selecting those third parties who may enforce a contract entered into by others and differentiating them from those who may not. "Few areas of contract law have consistently raised more thorny theoretical and practical difficulties for lawyers, judges, and scholars than the rights of nonparties to enforce contractual promises." *J. Crawford,*

CHIEF JUSTICE WRIGHT AND THE THIRD PARTY BENEFICIARY PROBLEM (1977) 4 Hastings C.L.Q. 769, 771-772.

At the core of the confusion and uncertainty is this. While each potential third-party beneficiary contract involves someone other than the contracting parties who stands to benefit from the contract's performance, such a contract may not be enforced by those who are only incidentally or remotely benefitted by its performance. *Martinez*, 11 Cal.3d at 400; *Lucas v. Hamm* (1961) 56 Cal.2d 583, 590. The problem thus becomes one of line-drawing. Courts and scholars have struggled to develop standards to differentiate those contract beneficiaries who are eligible to enforce from those who are not.

Civil Code §1559 provides that "[a] contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it." Unchanged since 1872, the wording of this statute has been of little help to date in deciding particular cases. The statute has come to be "engulfed by the Restatement, on the guiding assumption that the code sections embody general common law principles and that those principles are enunciated in the Restatement provisions with respect to the third party beneficiary problem." *Crawford, supra* at 783. While the statutory term "expressly" alluringly suggests a predictable standard, courts have held that qualifying third-party beneficiaries need not be expressly specified in a contract. *Spinks v. Equity Residential Briarwood Apartments* (2009) 171 Cal.App.4th 1004, 1023. Moreover, many courts have defined "expressly" as the mere opposite of the incidental or remote contract benefits that are insufficient to bestow third-party enforcement rights. *Id.* at 1022; *Gilbert Financial Corp. v. Steelform Contracting Co.* (1978) 82 Cal.App.3d 65, 70.

That is not to say that the term "expressly" has been robbed of all meaning. In order to find a third-party beneficiary contract, the intent of the contracting parties to benefit the third party must have been clearly manifested by the contracting parties. *Schauer v. Mandarin Gems of California, Inc.* (2005) 125 Cal.App.4th 949, 957-958. Each plaintiff "(must plead a contract which was made expressly for his [or her] benefit and one in which it clearly appears that he [or she] was a beneficiary.)" *Id.* at 957, quoting *California Emergency Physicians Medical Group v. PacifiCare of California* (2003) 111 Cal.App.4th 1127, 1138.

Most often, California courts have applied the third-party beneficiary framework found in the First Restatement of Contracts, and used by this Court in *Martinez*, 11 Cal.3d at 400. It extends third-party enforcement rights to "donee" and "creditor" beneficiaries but not to "incidental" beneficiaries. Under the First Restatement categories, a "creditor" beneficiary is one as to whom "the promisor's performance of the contract will discharge some form of legal duty owed to the beneficiary by the promisee." *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 him or to confer on him a right against the promisor." *Id.* at 400-401. As to each category, a central tenet is that the contracting parties must have intended to benefit the third party. *Sofias v. Bank of America* (1985) 172 Cal.App.3d 583, 587 ("[a]n intent to make the obligation inure to the benefit of the third party must have been clearly manifested by the contracting parties"). In particular, the promisor "must have understood that the promisee had such intent." *Lucas*, 56 Cal.2d at 591.

The First Restatement's "donee" and "creditor" classifications became "the subject of severe criticism primarily for being misleading because of the overlap and difficulty in classification in many cases." *Crawford, supra*, at 773 fn.18; *see also* H.G. Prince, PERFECTING THE THIRD PARTY BENEFICIARY STANDING UNDER SECTION 302 OF THE RESTATEMENT (SECOND) OF CONTRACTS (1984) 25 B. C.L.Rev. 919, 976 (recounting Second Restatement's drafting history).

While the Second Restatement addressed to a degree the classification concerns arising from the First Restatement's donee and creditor beneficiary categories, its Section 302 has not eliminated the challenges in identifying those third parties who benefit from a contract such that they may enforce it or sue for its breach. "Only while attempting to define the new intended beneficiary category did the drafters begin to focus on the more significant problem faced by courts in applying Section 133 [of the First Restatement] and similar rules, that is, the determination of standards for deciding when there is sufficient indicia of the parties' intent to justify granting a third party standing to enforce the promise." Prince, *supra*, at 976.

Section 302 replaces the "creditor" and "donee" classifications with an all-inclusive "intended" beneficiary category:

> (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or

(b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary

Despite the terminology changes, several California courts have concluded that the Second and First Restatements are not materially different. *E.g., Souza v. Westlands Water District* (2006) 135 Cal.App.4th 879, 893; *Walters v. Marler* (1978) 83 Cal.App.3d 1, 32 fn. 18. Commentators have agreed:

> "The change in Section 133 [of the First Restatement] was only a minimal change. The change in terminology...failed to address adequately the major problem of the intent standard.... The deficiency in the distinction between intended and incidental beneficiaries is that the parties, or more simply the promisee, may intend a third party to receive a benefit but not intend that party to have standing to enforce the promise. This type of third party, although intended to receive a benefit, would be characterized as an incidental beneficiary not only under the original Section 133 and similar state rules, but also under revised Section 302 of the Restatement (Second).

Prince, *supra*, at 977-978.

The focus on "intent to benefit" as the means to differentiate "incidental" from "intended" beneficiaries generates uncertainty and unpredictability: how do courts differentiate an intent to *incidentally benefit* a third party from an intent to *expressly or clearly benefit*? *See, e.g., Johnson v. Holmes Tuttle Lincoln-Mercury* (1958) 160 Cal.App.2d 290, 297 ("The parties are presumed to intend the consequences of a performance of the contract."); *accord, Prouty v. Gores Technology Group* (2004) 121 Cal.App.4th 1225, 1232-1233.

As Professor Eisenberg has pointed out, the term "intent" as used in the third-party beneficiary "intent to benefit test" is "deeply ambiguous." M.A. Eisenberg, THIRD-PARTY BENEFICIARIES (1992) 92 Colum. L. Rev. 1358, 1378. As he noted:

> If the intent-to-benefit test is satisfied by objective intent, it provides no guidance on the issue the test, as so formulated, makes critical: How is it to be determined, as an objective matter, why in some contracts whose performance will benefit a third party, the benefit is objectively "intended" within the meaning of the test, while in other contracts whose performance will benefit a third party, the benefit is not so "intended"?
>
> Perhaps to ameliorate these difficulties, some courts patch additional formal requirements onto the intent-to-benefit test. For example, some cases impose a requirement that an intent to benefit the third party be "clear," "express," or "definite," and some require that an intent to benefit the third party be found in the language of the contract itself, and cannot be established on the basis of surrounding circumstances. The former type of requirement is based on the erroneous assumption that contracting parties normally have a "clear," "express," or "definite" intent on benefiting the third party. Both types of requirement are inconsistent with modern principles of contract interpretation....

Id at 1379.

When scrutinizing a written contract, the fact that a literal contract interpretation would result in a benefit to a third party is not enough to allow that party to demand enforcement. "The contracting parties must have intended to confer a benefit on the third party." *Neverkovec v. Fredericks* (1999) 74 Cal.App.4th 337, 348. "Ascertaining this intent is a question of ordinary contract interpretation." *Hess v. Ford Motor Co.* (2002) 27 Cal.4th 516, 524. But ascertaining intent requires not only close scrutiny of contract terms but consideration of surrounding circumstances and course of performance lest, as the contract wording in *Hess* would have produced, a literal interpretation yields an unintended and unfair result.

These uncertainties of application are magnified in a case like this where an unwritten contract is alleged and the courts are unable to apply the same level of pleading scrutiny they bring when examining intent based on the terms of a written contract. "An oral contract may be pleaded generally as to its effect, because it is rarely possible to allege the exact words." *Khoury v. Macy's of California, Inc.* (1993) 14 Cal.App.4th 612, 616. Lax pleading standards deprive courts of the raw material needed to implement the challenging task of ascertaining the contracting parties' intent.

Here, the 6AC's allegations of an intent to benefit Altour employees are conclusory, meaning they should be disregarded. See, *post*, topic IVB5. The 6AC's more-specific allegations address consequences of the Altour-ADP relationship—benefits that may flow—but that is not helpful because even an incidental beneficiary is an intended recipient of contract benefits. Additionally, Plaintiff's allegations are largely "on information and belief." She does not claim, for example, to have been privy to the Altour-ADP contract terms, to the communications between the contracting parties or to their intent in contracting.[19]

Thus, another problem: glib, nonspecific allegations of an unwritten contract are not subject to judicial scrutiny in the same way written contracts are, thereby exposing

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[19] As ADP pointed out in its request for depublication, its written payroll-processing service contracts affirmatively disclaim any intent to create third-party enforcement rights. Plaintiff's allegations about an unwritten Altour-ADP contract are at odds with the widespread practice of providing payroll-processing services based on contracts in writing, as disclosed by the numerous *amici* who wrote to this Court urging that review be granted.

contracting promisors to unwarranted transactional costs in defending meritless claims that receive undeserved protection under lax pleading standards.

With these principles in mind, we now demonstrate why payroll service providers are not properly classified as third-party beneficiaries under either Restatement formulation.

2. Under The First Restatement-*Martinez* Standards, Plaintiff Is Not A Third-Party Beneficiary Of Her Employer's Payroll Service Provider Contract

The court of appeal misclassified Plaintiff as a third-party creditor beneficiary of an unwritten Altour-ADP payroll-processing services contract because several requirements for third-party creditor beneficiary status are not satisfied. This necessitates reversal of the court of appeal decision.

a. The "Discharge" Requirement Is Not Satisfied

A qualifying third-party creditor beneficiary contract is one where the promisor's performance discharges the promisee's obligations to the third-party beneficiary. *Martinez*, 11 Cal.3d at 400. A payroll service provider cannot "discharge" an employer's Labor Code or Wage Order obligations. The Legislature has fastened those duties on employers, who must answer for noncompliance not just to employees but to state and federal enforcement authorities. Thus, while an employer may hire payroll-processing assistance from an independent contractor, it cannot delegate its responsibilities because wage-and-hour laws promote the paramount public policy of assuring full and timely wage payments. The employer retains at all times "a duty to pay wages," *Martinez*, 49 Cal.4th at 49, in compliance with wage-and-hour law requirements.

These factors distinguish cases where third-party creditor beneficiary enforcement rights have been recognized. Past creditor beneficiary cases involve situations where the promisor agreed to render full, *substitute performance* of the promisee'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). The classic (and easiest) third-party creditor beneficiary contract is an agreement whereby the promisor assumes the promisee's obligation to pay a debt owed to a third party. *Calhoun v. Downs* (1931) 211 Cal. 766, 770-771 (agreement to assume obligation to pay brokerage commission); Second Restatement, *supra*, §302(1)(a). No such assumption is possible as to an employer's wage-and-hour law responsibilities. And past creditor-beneficiary cases do not involve situations, as here, where the employer is not just obligated to a private party, but answerable to government authorities by way of their civil and criminal enforcement powers.

Moreover, the 6AC's allegations are *not* that ADP discharges, or renders substitute fulfillment, of Altour's wage-and-hour duties. The 6AC alleges that ADP provides "services" that assist Altour with wage payments and statements. Thus, the 6AC alleges that "ADP contracted with Altour to provide *services*...including the calculation of Plaintiff's hours for the benefit of plaintiff...," AA-72, ¶185. These services included "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." AA-72, ¶187. While the 6AC alleges Altour relied on ADP to do appropriate, accurate calculations, AA-72, ¶185, the 6AC repeatedly alleges that *Altour*

and ADP both provided plaintiff "paychecks and earning statements" AA-66, ¶149, and that both "confusingly" "elected" applicable payroll periods, *id.*, ¶150. Under such allegations, ADP does not perform in place of Altour. Notably, the 6AC does not allege that ADP took over Altour's wage-and-hour responsibilities. Insofar as the court of appeal thought ADP took over Altour's payroll department functions, MOp.-2, that conflicts with what the 6AC alleges. The 6AC alleges that "Plaintiff's time cards" "contained facts requiring" compensation she did not receive, AA-66, ¶148, thus underscoring that ADP, like other payroll service providers, performs "largely ministerial task" of calculating wages using information supplied by the employers and employees. *Futrell*, 190 Cal.App.4th at 1432. That makes ADP unlike a promisor in a typical creditor beneficiary—who renders complete, substitute performance. Acting with all due care, ADP cannot generate accurate paychecks or wage statements if it is supplied with incomplete or erroneous data about work hours and breaks.

The court of appeal relied upon *Soderberg v. McKinney* (1996) 44 Cal.App.4th 1760, 1771-1774 and *Del E. Webb Corp. v. Structural Materials Co.* (1981) 123 Cal.App.3d 593, 606-607. Neither is analogous. Neither involves obligations imposed by statute and enforceable by governmental entities. In both cases, the contracts addressed discrete transactions over which the promisor took control. Performance would discharge an obligation the promisee owed to the third-party beneficiary. Thus, in *Soderberg*, Op.-23-24, a mortgage broker contracted for an appraisal that the broker used to solicit investors. The appraiser had exclusive control over the undertaking. In *Del E.*

Webb Corp., Op.-25, a supplier agreed to provide roofing materials to a subcontractor on a construction project. The supplier had exclusive control over the materials.

This case is also unlike precedents because it involves an ongoing relationship between Altour and ADP, where recurring performance will occur over time, and not a finite, defined obligation like an agreement to discharge someone's debt to a third person.

Here, ADP does not discharge the employer's nondelegable obligation to comply with state and federal wage-and-hour laws. Rather, payroll service providers assist with employer wage-and-hour obligations just as payroll department employees typically do for those employers who do not hire outside assistance. An added problem with the court of appeal decision is that, if payroll service providers are amenable to suit, why does responsibility for wage-and-hour compliance stop there? Lawyers, accountants, banks and others can be involved in the process of employers paying their workers. Indeed, Plaintiff's lawyer argued at the court of appeal that employees should be viewed as third-party beneficiaries of contracts by which their employers hire courier companies or messengers to deliver paychecks.

And if the court of appeal's analysis is endorsed, others who contract to provide goods or services to employers that benefit employees are open to classification as third-party beneficiaries under the ripple effects of the court of appeal's overbroad analysis. "A broad grant of power to claim under the contract to everyone who could show that he would have benefited by a performance, and hence had lost by a breach would have made a shambles of the law." A. Mueller & A. Rosett (1971) Contract Law and Its Application 498.

b. The "Clear Intent To Benefit" Requirement Is Not Satisfied

A third-party creditor beneficiary contract must disclose a ***clear intent*** "to make the obligation inure to the benefit of the third party…[that result must be] clearly intended by the contracting parties." Op.-22, quoting in part *Schauer*, 125 Cal.App.4th at 957-958.

No such intent is reasonably inferable here. Rather, Altour hired ADP intending to benefit itself—the employer with nondelegable wage-and-hour law duties that must be fulfilled in order to avoid liabilities, penalties and other sanctions. While a travel agency like Altour is presumably expert at bookings and related services, it understandably needed help with functions outside its core business. It hired ADP for the complicated—if ministerial task—of payroll preparation.

There is also no "intended benefit" to Plaintiff from the contract between Altour and ADP. Altour's employees are entitled to receive their wages whether or not their employer engages a payroll service provider.

c. The "Principal Purpose" Requirement Is Not Satisfied

A finding of third-party beneficiary status is also unwarranted because cases involving service provider contracts must distinguish agency and independent contractor relationships, where service providers owe duties to their employer-principals, not to third parties who benefit by the assistance rendered to the employer-principal. Some limits are needed to prevent diluting the duties service providers owe to those who hire

them. Courts rarely impose on service providers duties extending to "a party with whom the[ir] client dealt at arm's-length." *Sooy v. Peter* (1990) 220 Cal.App.3d 1305, 1313.

A third-party beneficiary relationship does not exist as to service providers unless the *principal purpose* of the promisee (employer) in hiring the promisor (service provider) is to benefit the third party (employee) instead of the promisee (employer). Such is not the case when an employer hires a payroll service provider.

California law embraces the importance of protecting the lines of responsibility associated with service provider relationships like these. Civil Code §2343 provides:

> One who assumes to act as an agent is responsible to third persons as a principal for his acts in the course of his agency, in any of the following cases, and in no others:
>
> 1. When, with his consent, credit is given to him personally in a transaction;
>
> 2. When he enters into a written contract in the name of his principal, without believing, in good faith that he has authority to do so; or,
>
> 3. When his acts are wrongful in their nature.

Courts applying this statute hold that those who assist a principal are generally not amenable to suit by the third persons with whom their principal deals. *See, e.g., Jones v. Gregory* (2006) 137 Cal.App.4th 798, 804-805, 807; *Automatic Poultry Feeder Co. v. Wedel* (1963) 213 Cal.App.2d 509, 518; *La Rosa v. Glaze* (1936) 18 Cal.App.2d 354, 357. "Under the common law, corporate agents acting within the scope of their agency are not personally liable for the corporate employer's failure to pay its employees' wages. (*See, e.g., Oppenheimer v. Robinson* (1957) 150 Cal.App.2d 420, 424; *see generally* 1 FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS (Supp. 2002) §41).

This is true, regardless of whether a corporation's failure to pay such wages, in particular circumstances, breaches only its employment contract or also breaches a tort duty of care." *Reynolds v. Bement* (2005) 36 Cal.4th 1075, 1087. These rules make clear that a service provider's work on behalf of an employer is insufficient to establish a third-party beneficiary contract relationship or an intent that such a relationship be formed.

The principal purpose requirement provides an apt basis to identify the limited class of service provider contracts as to which an intent to benefit third parties can be discerned. *Goldberg v. Frye* (1990) 217 Cal.App.3d 1258, 1268-69, held that a fiduciary's contract with an attorney did not confer rights on estate beneficiaries even though those beneficiaries would obviously and naturally benefit from the attorney's work for the fiduciary. The absence of any contractual privity or principal purpose to benefit the beneficiaries foreclosed imposition of a duty (as necessary for the tort of negligence) running from the fiduciary's attorney to the beneficiaries. This same analysis applies to third-party beneficiary contract rights. *Goldberg* noted that, in deciding whether to impose a duty running toward someone not in privity of contract with the professional services advisor-attorney,

> "[t]he predominant inquiry...is whether the principal purpose of the attorney's retention is to provide legal services for the benefit of the [noncontracting third-party] plaintiff."

Id. at 1268.[20] This Court has similarly held that, when "the main purpose" of hiring the service provider (attorney) was to benefit a third party, a third-party beneficiary contract can be found. *Lucas*, 56 Cal.2d at 590.

In a third-party creditor beneficiary situation, "the main purpose of the promisee is not to confer a benefit on the third party beneficiary, but to secure the discharge of his debt or performance of his duty to the third party." *Hartman Ranch*, 10 Cal.2d at 245. Assistance with payroll is not like discharge of a debt. It involves rendition of a service to the employer, not performance by the payroll service provider in place of that of the employer.

For each of these reasons, Plaintiff is not properly classified as a third-party beneficiary under the First Restatement or the *Martinez* test.

3. Under The Second Restatement, Plaintiff Is Not A Third-Party Beneficiary Of Her Employer's Payroll Service Provider Contract

The same factors discussed to this point also demonstrate that Plaintiff is not properly classified as a third-party beneficiary based on the Second Restatement. The Second Restatement's change in terminology—substituting "intended" beneficiary for "donee" and "creditor" beneficiaries—does not signal a change in those substantive requirements for finding a third-party beneficiary contract discussed above. *See* Eisenberg, *supra*, at 1382-1383. The Second Restatement's "intended" beneficiary category largely mirrors the First Restatement's categories—particularly the "creditor"

[20] This Court has described the *Goldberg* decision as "entirely correct" but inapplicable to duties owed to a successor fiduciary—a distinction irrelevant here. *Borissoff v. Taylor & Faust* (2004) 33 Cal.4th 523, 530.

beneficiary category. The Second Restatement is still focused on "inten[t] to give the beneficiary the benefit of the promised performance." Second Restatement, *supra*, §302(1)(b). If anything, the Second Restatement requires a more searching exploration of "intent" given its focus on discerning intent to benefit a third party that is "manifested" rather than "actual" but opaque. *Id.* ("the circumstances indicate that the promisee interests....")

Likewise, just as the First Restatement required that a creditor beneficiary "discharge" an obligation owed by the promisee to the third-party beneficiary, the Second Restatement envisions an "intended beneficiary" who benefits from performance that "will satisfy an obligation of the beneficiary to pay money to the beneficiary...." Second Restatement, §302(1)(a); *see also* comments ("Subsection 1(b) applies to "promises to satisfy a duty").

Applying the Second Restatement framework, Plaintiff is not a third-party beneficiary of Altour's payroll-processing services contract with ADP.

4. Policy Considerations Strongly Disfavor Classifying Payroll Service Provider Agreements As Third-Party Beneficiary Contracts Intended To Benefit Employees

In fashioning common-law principles, courts take public policy considerations into account. *See Brown v. Kelly Broadcasting Co.* (1989) 48 Cal.3d 711, 739.

An action by a third-party beneficiary does not rest on the ground of any actual or supposed relationship between the parties, but rather "on the broad and more satisfactory basis that the law, operating on the acts of the parties, creates a duty,

establishes a privity, and implies the promise and obligation on which the action is founded." *Johnson*, 160 Cal.App.2d at 297.

Many public policy considerations cut against implying a promise or obligation owed by payroll service providers to their customers' employees. Creating third-party beneficiary liability would be redundant to the liability provided by the wage-and-hour laws. It would confer no benefit on employees or employers. The employee's long-established right to obtain wages from the employer remains unchanged even if the employee were permitted now to bring a redundant claim.

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 promised compensation will take more time and cost more. 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 or subrogation right back against the employer for any judgment against it for improper payment of wages. Thus, the court of appeal's decision creates a redundant, circular and wasteful new claim that benefits no one. It does, however, subject payroll service providers to the burden and expense of defending wage-and-hour lawsuits which are proliferating, often in class-action form. Unclear and unpredictable standards for identifying third-party beneficiary contracts expose defendants to expensive transactional costs associated with defending unnecessary and meritless cases. Geis, BROADCAST CONTRACTING (2012) 106 Northwestern U.L. Rev. 1153, 1196. Such outcomes do not advance public policy.

Wage-and-hour litigation has become widespread in California, and the costs of participating in such cases are substantial. Cases evaluating standards for identifying third-party beneficiary contracts have not grappled with situations where third-party beneficiary classifications will impose burdensome transactional costs and litigation risks, as would be the case here.

Recognizing liability will also undercut the certainty and predictability that is a basic precept of contract law. Because the standards used to determine third-party beneficiary rights produce unpredictable results, parties who set out to establish purely bilateral relationships can find themselves exposed to claims from—and responsibilities toward—persons with whom they have no contractual relationships and as to whom no direct relationship was intended. "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." Eisenberg, THIRD PARTY BENEFICIARIES (1992) 92 Colum. L. Rev. 1358, 1379.

Recognizing liability will also dilute and blur the employer's wage-and-hour obligations. Nondelegation rules apply to important statutory duties because it is important to firmly fasten responsibility and accountability on the actor best situated to assure compliance. As to wage-and-hour responsibilities, that is the employer. A clear line of responsibility avoids finger-pointing, cross-allegations, and other wrangling that could inject delay and detract from the current system that settles employer-employee and employer-state obligations *inter se*, while still leaving the employer with its contract recourse against payroll service providers.

Recognizing liability also intrudes into the Legislature's domain and circumvents the exclusive remedies the Legislature has created. If the Legislature thinks wage-and-hour law obligations should extend more broadly, it is best able to evaluate whether broader liability will enhance compliance or create purposeless distractions that increase costs and delay resolution without providing counterbalancing benefits.

5. California Law Could Be Refined To Bring More Clarity To Identifying Third-Party Beneficiary Contract Situations

The Court need go no further in considering whether Plaintiff is a third-party beneficiary of the Altour-ADP payroll service contract. But the Court could consider refining the standards used to identify third-party beneficiary contracts.

"[T]he legal treatment of [third-party] beneficiaries is a major source of contention in contract law." Geis, *supra*, at 1153. Uncertainties arise because of the importance of ascertaining intent when deciding whether third-party beneficiary contract rights should be recognized.

> How can judges unpack, in an objective manner, whether a contract that favors a given person or a group (directly or indirectly) manifests an intent to provide third party recourse? Courts need to look beyond the mere fact of the benefit itself; otherwise anyone positively impacted by the contract could pursue a claim. But any recognition of a benefit with ambiguous intent to a third party is problematic. We are walking on very thin ice when we purport to objectively allow the claims of one group while insisting that other benefits or other groups are merely incidental and thus unenforceable.

Geis, *supra*, at 1165.

"[T]he legal treatment of third party claims relies far too heavily on judicial conjecture about vague standards and ambiguous classification rubrics." *Id.* at 1157. For example, findings of clear intent to benefit third parties are complicated by rules like

"[t]he parties are presumed to intend the consequences of a performance of the contract." *Johnson*, 160 Cal.App.2d at 297. Such an inquiry into intent, or the parties' manifestation of their intent, does not differentiate incidental from intended beneficiaries. "[A]lthough courts speak forcefully and convincingly of having discovered the intent of the parties, this discovery is in fact an agreed fiction." Crawford, *supra*, at 785. As Professor Corbin has stated,

> [t]he ideas that lie behind such terms as "purpose," "motive," and "intention" are obscure and elusive, as has been found in the criminal law as well as the civil. When a contract is made, the two or more contracting parties have separate purposes; each is stimulated by various motives, of some of which he may not be acutely conscious. The contract itself has no purpose, motive or intent. The parties have purposes, motives, and intentions; but they never have quite the same ones.

Crawford, *supra*, at 875, quoting in part Corbin, CONTRACTS (2d ed. 1965), §766. And the challenge of ascertaining intent is magnified when the alleged third-party beneficiary contract is unwritten, meaning judicial scrutiny of the terms is undermined by indulgent pleading rules. The challenge is also magnified when the contract is one to provide third-party independent contractor services that clearly benefit the promisee by supplying expertise or services it cannot provide for itself. The governing standard for identifying a third-party beneficiary ought to be something better than a variation on Justice Stewart's famous test of obscenity: "I know it when I see it." *Jacobellis v. Ohio* (1964) 378 U.S. 184, 197 (concurring opinion).

One way the Court could refine the standards for identifying third-party beneficiary contracts would be to determine if the contracting parties' agreement "indicate[s], at a minimum, that outside rights will be available to certain parties, and it

should provide a judge with a plausible formula or framework for determining whether a given outside litigant falls within this defined class. Otherwise, an outside claim should be rejected." Geis, *supra*, at 1195.

Such requirements would comport with California law. They would implement Civil Code §1559's statutory requirement that contracting parties must "expressly" signify their intent to confer third-party rights. The "expressly" term in that early statute wisely injected an element of clarity and predictability that seems to have been diluted in subsequent court interpretations. *See, ante*, topic IVB1.

Professor Eisenberg proposes a "third party-beneficiary principle" because "the intent-to-benefit test and its variations, and the Restatement tests are all inadequate and indeed largely meaningless." Eisenberg, *supra*, at 1385.

> A third-party beneficiary should have power to enforce a contract if, but only if:
>
> (I) allowing the beneficiary to enforce the contract is a necessary or important means of effectuating the contracting parties' performance objectives, as manifested in the contract read in the light of surrounding circumstances; or
>
> (II) allowing the beneficiary to enforce the contract is supported by reasons of policy or morality independent of contract law and would not conflict with the contracting parties' performance objectives.

Ibid.

Applied here, the Eisenberg test disfavors the court of appeal's holding. It is not necessary to give employees further remedies in order to effectuate the purposes of a payroll service contract, and creation of such remedies blurs and dilutes the public policies supporting clear employer responsibility to discharge wage-and-hour obligations.

Another solution for cases involving unwritten contracts is to require pleading of more than the legal effect of the contract, namely, the facts forming the basis for each plaintiff's asserted third-party beneficiary rights. Required allegations should address the factual basis upon which a plaintiff claims that the contracting parties intended to benefit plaintiff and authorized plaintiff to sue. In particular, required allegations should address the basis by which the promisee manifested to the promisor the intent to benefit the third party, given case law suggesting that it is the intent of the promisee, as understood by the promisor, that counts. *Lucas*, 56 Cal.2d at 591. Such requirements would align with what a plaintiff must plead and prove in order to qualify as a third-party beneficiary. *Neverkovec,* 74 Cal.App.4th 348-349 (burden of proof on plaintiff to establish third-party beneficiary status); *California Emergency Physicians*, 111 Cal.App.4th at 1138 ("plead a contract which was made expressly for his benefit and one in which it clearly appears that he was a beneficiary").[21]

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[21] The 6AC lacks adequate allegations. It asserts that ADP advertised and stated in its corporate reports "goals of aiding the employees of the employer with whom they contact"; from this it is asserted that the ADP-Altour payroll services agreement was "intending to benefit both Altour and its employees." 1-AA-72, ¶176. But the allegations of intent to benefit Altour employees are conclusory, *id*, at 72, ¶¶186-187, and it does not follow as a logical inference that the intent of the Altour-ADP contract was to benefit anyone other than Altour, with incidental benefits flowing to Altour employees. Likewise, allegations that ADP understood applicable laws, *id.* at 72, ¶184 or that Altour "relied on ADP to do the appropriate and accurate calculations," *id.* at 72, ¶185, do not show that Altour intended anything other than ADP's assistance in fulfilling its nondelegable wage-and-hour law obligations. And allegations that ADP's contract services would benefit Altour employees, aid them, or provide them with useful information, show only that statutorily required benefits might flow to those employees, not the intent of the contracting parties to allow Altour employees to enforce the Altour-ADP contract.

This Court could act in this case to bring greater clarity to the standards used to identify third-party beneficiary contracts. Nevertheless, it is not necessary to do so. For the reasons discussed earlier, under both the First and Second Restatement tests, Plaintiff has no third-party beneficiary enforcement rights.

C. Employees May Not Sue Their Employers' Payroll Service Providers For Professional Negligence

A tort cause of action for professional negligence does not lie in favor of an employee based upon a payroll service provider's errors when providing payroll assistance to the plaintiff's employer. Indeed, given the broader measure of damages available for tort claims, any negligence cause of action would expose payroll service providers to greater potential liability for compliance with employer wage-and-hour duties than the employers who have those duties imposed upon them.

1. If Plaintiff Is Not A Third-Party Beneficiary, Then The Basis For Finding A Negligence Duty Disappears

Once this Court repudiates ADP's third-party beneficiary status, the basis for imposing a cause of action for professional negligence disappears. Any claim for negligence requires the existence of a duty. The court of appeal found a duty because it erroneously viewed Plaintiff as a third-party creditor beneficiary of the Altour-ADP payroll-processing contract.[22]

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[22] The court of appeal's stated premise in recognizing a professional negligence cause of action was that it "confront[ed] the question not resolved" in this Court's decision in *Bily*, which the court of appeal described as "whether a financial services provider may be subject to a duty of care to a third party beneficiary of the contract between the provider and its client." Op.-40. But *Bily* identified its unresolved question (in footnote 16) very differently: "whether and under what circumstances express third party beneficiaries of

Nevertheless, the flaws in recognizing a professional negligence cause of action cut deeper and defeat such a negligence claim, whether or not Plaintiff is a third-party beneficiary of the Altour-ADP contract.

2. The Factors Relevant To Imposing A Tort Duty In Favor Of A Third Party Are Not Present Here

Claims for professional negligence have been recognized in cases involving certain professions subject to licensing, regulation and/or rules of professional conduct (like doctors and lawyers). *See, e.g., Moreno v. Sanchez* (2003) 106 Cal.App.4th 1415, 1435 (California recognizes professional negligence against a home inspector because a statute imposes on inspectors an independent duty to those who hire them, in addition to any contract duties). But no California case (save the court of appeal decision here) has recognized a professional negligence claim applicable to payroll service providers. Nor do other jurisdictions recognize such claims.[23] Professional negligence claims lie because "[t]hose undertaking to render expert services in the practice of a profession or trade are required to have and apply the skill, knowledge and competence ordinarily

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audit engagement contracts may recover as 'clients' under our holding." The court of appeal answered a very different question than that posed by *Bily* and got the answer wrong.

[23] Other jurisdictions have shown great reluctance to recognize new professional negligence claims. For example, with respect to a parallel "service provider" of more recent vintage that does not perform tasks that otherwise would be performed by the client, states have uniformly rejected claims of professional negligence against computer/software consultants, holding that they have no duty of care independent of their contracts. *See, e.g., Avazpour Networking Servs., Inc. v. Falconstor Software, Inc.* (E.D.N.Y. 2013) 937 F.Supp.2d 355, 364; *Heidtman Steel Prods., Inc. v. Compuware Corp.* (N.D. Ohio Feb. 15, 2000) 2000 WL 621144, at *13-14; *Ferris & Salter P.C. v. Thomson Reuters Corp.* (D. Minn. 2012) 889 F.Supp.2d 1149, 1151-53; *Chatlos Sys., Inc. v. Nat'l Cash Register Corp.* (D.N.J. 1979) 479 F.Supp. 738, 740.

possessed by their fellow practitioners...and failure to do so subjects them to liability for negligence." *Estate of Beach* (1975) 15 Cal.3d 623, 635. By contrast, payroll service providers perform "largely a ministerial task," *Futrell*, 190 Cal.App.4th at 1432, and one that otherwise is performed by the employer. No statute, regulation or rule requires that payroll service providers have particular skills. There are no state licensing requirements like those governing traditional professions.

Recognition of a duty—and thus a professional negligence cause of action—is also unwarranted based on the factors set out in *Biakanja*, 49 Cal.2d at 650, and kindred cases. Deciding whether a defendant will be liable to a third person not in privity is a matter of policy that involves balancing various factors. These include "the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm." *Ibid.* These factors compel the conclusion that no tort duty is owed by ADP.[24]

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[24] Finding no tort duty on the part of a payroll-processing service provider is also supported by the court of appeal's decision in *Giacometti v. Aulla, LLC* (2010) 187 Cal.App.4th 1133, which it cited. Op.-44, fn.10. *Giacometti* applied the *Biakanja* factors to find that no professional negligence claim could be asserted by employees against accountants hired by their employer to create year-end earnings and tax documents, including the W-2 forms that were sent to employees for use in preparing their taxes. The parallels to this case are obvious. The court of appeal in *Giacometti* conceded that it was foreseeable that incorrect information on W-2 forms could harm employees, but concluded "that alone does not create a duty." Per the court, the employer hired the accountants "not to benefit the employees but to fulfill a legal obligation to furnish pay information to the IRS." *Id.* at 1140. So it is here. Altour hired ADP to help fulfill its wage-and-hour law obligations.

According to the court of appeal's analysis, ADP's work for Altour was intended to take "over the functions ordinarily assigned to an employer's internal payroll department" (Op.-16) and therefore assist Altour. ADP's work was not intended to "affect" Plaintiff, since her employer had duties to comply with wage-and-hour laws whether or not ADP assisted. There was no foreseeability of harm to Plaintiff by any action of ADP, since Plaintiff has remedies against her employer for any improper wage payment or statement, whatever the cause. There is no certainty that Plaintiff would suffer any injury from any action by ADP for the same reasons. There is no closeness of connection between ADP's conduct and Plaintiff's allegedly improper wages: Altour is responsible for paying proper wages, and employees have a direct right against Altour to obtain them. There is certainly no moral blame to attach to ADP's conduct, since its work was performed to assist Altour and was, at most, negligent.

Lastly, the policy of preventing future harm is not advanced, but impeded, by imposing a tort duty. Prior to the court of appeal decision, allegations of wage-and-hour violations were resolved by wage-and-hour claims against employers prosecuted by employees, by the state or via representative, private party enforcement actions under PAGA. *See, ante*, topic IVA. If liability resulted because of the work of a payroll service provider, that issue was resolved pursuant to the contract between the employer and the provider. Moreover, a service provider who makes mistakes could be expected to be replaced by one of its many marketplace competitors. Shifting liability to payroll service providers for employer wage obligations can only discourage employer vigilance in discharging legal obligations.

Even if a payroll service provider "takes over" an employer's payroll department, it is performing "largely a ministerial task, albeit a complex task in today's marketplace." Op.-15, *quoting Futrell*, 190 Cal.App.4th at 1432. The provider is, like the accountant in *Bily*, 3 Cal.4th at 376, dependent on data generated by others to perform its work. When service providers perform limited functions, under contract to one party, the *Biakanja* test disfavors imposition of a duty of care to third parties. *See, e.g., Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002) 27 Cal.4th 705, 711 (escrow holder has no duty to third party when it performs limited functions of discharging instructions).

Recognizing a tort duty by a payroll service provider would only create a redundant, expensive, complicating and ultimately pointlessly circular claim that would benefit no one (except perhaps lawyers). Any plaintiff may (as here) allege fictionalized, unwritten payroll service contracts in order to multiply the number of defendants and get past a demurrer. Such claims will only increase costs, delay and uncertainty.

3. If Plaintiff Is Viewed As A Third-Party Beneficiary, That Negates Recognition Of A Negligence Cause Of Action

Even if employees are third-party beneficiaries, recognition of a negligence cause of action is incompatible with established California jurisprudence.

Tort claims are unavailable for alleged breaches of duty that merely restate contractual obligations. Breaching a contract does *not* create a tort claim, and "dual" contract-tort actions may be maintained *only* where the duty that gives rise to the tort claim is "*completely independent of the contract.*" *Erlich v. Menezes* (1999) 21 Cal.4th

543, 552; *see also Aas v. Superior Court* (2000) 24 Cal.4th 627, 643 (negligence claim unavailable: "[a] person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations"); *Hunter v. Up-Right, Inc.* (1993) 6 Cal.4th 1174, 1181, 1184-85.

The professional negligence claim alleged here does not satisfy the requirement of *complete independence* from the third-party beneficiary contract claim. The same conduct by ADP is alleged as the basis for each cause of action. 1-AA-68, 72 (negligence and third-party beneficiary causes of action largely rest on same, incorporated earlier allegation). The 6AC's allegations of professional negligence and breach of a third-party beneficiary contract are *coextensive and related.* If Plaintiff is the third-party beneficiary of the contract between her employer and ADP, then her sole remedy is an action on that contract. Tort claims are barred.

Recognition of any negligence cause of action would also conflict with California's economic loss rule. That rule "prevent[s] the law of contract and the law of tort from dissolving one into the other" by requiring that a party may only "recover in contract for purely economic loss due to disappointed expectations, unless [that party] can demonstrate harm above and beyond a broken contractual promise." *Robinson Helicopter Co., Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 988. Courts have consistently recognized that negligence claims for economic losses are barred. *Zamora v. Shell Oil Co.* (1997) 55 Cal.App.4th 204, 213; *United Guaranty Mortgage Indem. Co. v. Countrywide Fin. Corp.* (C.D. Cal. 2009) 660 F.Supp.2d 1163, 1183-85; *Neu v. Terminix Int'l, Inc.* (N.D. Cal. April 8, 2008) 2008 WL 962096.

This Court has recognized only a narrow exception to the economic loss rule and the allegations. Plaintiff's 6AC does not meet it. To avoid the bar of the economic loss rule, tortious conduct must meet two specific, narrow requirements: (1) alleged tortious conduct must be "separate from the breach itself" *and* (2) harm flowing from that conduct must "expose a plaintiff to liability for personal damages *independent of the plaintiff's economic loss*." *Robinson Helicopter*, 34 Cal.4th. at 991 93. The 6AC alleges only economic damages. The case law is replete with examples of courts applying the economic loss rule to bar recovery in cases, like this one, where plaintiff has brought tort claims relating to the performance of a professional services contract.[25]

D. Employees May Not Sue Their Employers' Payroll Service Providers For Negligent Misrepresentation

The court of appeal erroneously recognized, also for the first time under California law, a cause of action for negligent misrepresentation against payroll service providers, based on allegations "that appellant's earnings statements, as provided by ADP, were inaccurate and omitted statutorily required information...." Op.-28.

If Plaintiff is a third-party beneficiary of the contract between her employer and ADP, then, as discussed in the preceding section, she is barred from asserting a negligent

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[25] *WeBoost Media S.R.L. v. LookSmart Ltd.* (N.D. Cal. June 12, 2014) 2014 WL 2621465 at *5-*6; *JMP Sec. v. Altair Nanotechnologies, Inc.* (N.D. Cal. 2012) 880 F.Supp.2d 1029; *Audigier Brand Mgmt. v. Perez* (C.D. Cal. Nov. 5, 2012) 2012 WL 5470888; *Legal Additions LLC v. Kowalski* (N.D. Cal. March 19, 2010) 2010 WL 1038444, at *9-*14, *on reconsideration*, (N.D. Cal. May 18, 2010) 2010 WL 1999894; *Multifamily Captive Grp., LLC v. Assurance Risk Managers, Inc.* (E.D. Cal. 2009) 629 F.Supp.2d 1135, 1145-46; *Intelligraphics, Inc. v. Marvell Semiconductor, Inc.* (N.D. Cal. Feb. 10, 2009) 2009 WL 330259, *17-*18.

misrepresentation claim under this Court's precedent restricting tort remedies for contract breaches and denying recovery for economic losses.

If, on the other hand, Plaintiff is not a third-party beneficiary of the Altour-ADP contract, then the negligent misrepresentation cause of action necessarily fails because the court of appeal relied on its third-party creditor beneficiary classification to justify tort liability. Op.-31-32.

In addition, while dubiously treating payroll service providers as "experts," subject to professional negligence liability, the court of appeal has erroneously failed to apply recognized "limitation[s] applicable to claims against professionals such as auditors, attorneys, architects, engineers and title insurers, who generally provide reports or opinions to client on the basis of information supplied by the clients." Op.-30. Under the Restatement (Second) of Torts §552(2), which the court of appeal used as its analytical framework, the liability of service providers is limited to "loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction." Op.-30 fn.7. "This limits liability 'only to those persons for whose benefit and guidance [the third-party services are] supplied,' as 'distinct from the much larger class who might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon it.'" Op.-30-31 fn.7, quoting in part Restatement, *supra*, §552, comment h.

Sanctioning a negligent misrepresentation cause of action would conflict with this Court's *Bily* decision, 3 Cal.4th at 370, and the limits *Bily* places on negligent misrepresentation liability. Like the auditor in *Bily*, a payroll service processor is a secondary actor who must rely on data supplied by the employer. A payroll service provider has no ability to prepare payroll unless it receives the data from which payroll and wage statements may be prepared. Plaintiff acknowledged this fact in her appellate court briefing. AOB-2. Whether data comes from employer or employee, the payroll preparation function involves use of data supplied by others, and it is "[l]argely a ministerial task...." Op.-15.

The court of appeal thought a difference lies in the nature of ADP's role because "inaccuracy in the earnings statements are alleged to have arisen from ADP's own conduct, not from errors in the time cards provided to ADP." Op.-33. But the liability that was limited in *Bily* was auditor liability for *its* mistakes in analyzing the financial data supplied to it and certifying that financial statements were prepared according to accounting standards. In service provider cases like *Bily*, the limits on tort liability exclude claims for what would otherwise be provider liability for its own culpable negligence.

In addition, ADP assists in providing *the employer's* wage calculations and statements. If the employer can only be sued in contract for its calculations and statements, those who assist in preparing the calculations and statements on the employer's behalf should not face the potentially greater liabilities that come with the tort law.

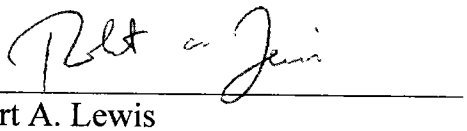
V. CONCLUSION

The decision of the court of appeal should be reversed with directions to affirm the trial court's judgment for ADP.

Dated: April 17, 2017

Respectfully submitted,

MORGAN, LEWIS & BOCKIUS LLP

By: 

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CERTIFICATION OF WORD COUNT

I hereby certify that pursuant to California Rules of Court, Rule 8.204(c)(1), the attached brief, including footnotes, but excluding the caption page and this certification, contains 13,567 words, as counted by the Microsoft Word 2010 word-processing program and is produced using 13-point Times New Roman type used to generate the brief.

Dated: April 17, 2017

MORGAN, LEWIS & BOCKIUS LLP

By: _____

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CERTIFICATE OF SERVICE

I, Davace Chin, declare that I am a resident of the State of California, County of San Francisco. I am over the age of eighteen years and not a party to the within action; my business address is Morgan, Lewis & Bockius LLP, One Market Street, Spear Tower, San Francisco, California 94105.

On April 17, 2017, I caused the following document to be served:

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I declare under penalty of perjury, under the laws of the United States of America and the State of California, that the above is true and correct. Executed on April 17, 2017, at San Francisco, California.

By: D. Chin
Davace Chin