Case No. S238941



**IN THE SUPREME COURT OF THE STATE OF CALIFORNIA**

SHARMALEE GOONEWARDENE, an individual,
*Plaintiff and Appellant,*

vs.

ADP, LLC; ADP PAYROLL SERVICES, INC.; AD PROCESSING, LLC,
*Defendants and Respondents.*

On Review of a Decision of the California Court of Appeal,
Second Appellate District, Division Four, No. B267010

On Appeal from the Superior Court of California,
County of Los Angeles
The Hon. William Barry, Judge
Civil Case No. TC026406

# PETITIONERS' REPLY BRIEF ON THE MERITS

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## I. INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### B. Wage Statement Claims And Remedies Are Exclusive

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

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

### C. Overtime Pay Claims And Remedies Are Exclusive

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

> Altour and ADP entered into an unwritten contract whereby ADP provided payroll calculation, records maintenance, and a host of related services to Altour for the benefit of Altour and its employees in the general area of employee wages and benefits.

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

employees since, as Altour fulfills its wage-and-hour obligations, Altour employees will benefit too.

Plaintiff claims ADP is poorly positioned to criticize Plaintiff's allegations about intent, RB–7, and has erroneously referred to the intent of both Altour and ADP, rather than just the intent of Altour alone. Wrong on both counts. First, ADP invoked both the rule and the authority Plaintiff cites, namely, that "it is sufficient that the promisor must have understood that the promisee had such intent" to benefit a third party. AOB–23; RB–7; *see Lucas v. Hamm* (1961) 56 Cal.2d 583, 591. Second, as that statement shows, the promisor's intent is also relevant because the promisor must understand the promisee's intent to benefit the third-party beneficiary. What both know and intend is important.[12]

More importantly, this Court is evaluating rules potentially applicable to the entire payroll processing industry, and to other types of contracts where third-party beneficiary rights might be claimed. Many different types of service providers assist

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[12] Plaintiff claims deficiencies in her allegations are attributable to ADP's refusal to produce documents during discovery that occurred before ADP's demurrer was sustained. RB–10. That misconstrues the record. The trial court stayed discovery pending a ruling on ADP's demurrer. RA-33. ADP complied with the court's order. While ADP voluntarily produced certain documents designed to show Plaintiff that she had sued the wrong parties, no broader discovery was allowed by the trial court at the demurrer stage. Courts often defer discovery until after the pleadings are settled. *See, e.g., Terminals Equip. Co. v. City & Cty. of San Francisco* (1990) 221 Cal.App.3d 234, 247. Plaintiff's discovery grievance excuse also rings hollow because she had been in litigation with her employer (Altour) before she sued ADP. 1-AA-3. She could have pursued discovery from her employer as to its payroll processing arrangements.

employers in ways that confer derivative benefits on employees or customers.[13] Rules developed in this case will reach beyond the facts here to a myriad of other situations. While this case must be decided on its record, that is not to say the Court can turn a blind eye to the broader implications of its decisions.

Plaintiff does not surmount ADP's point that one way to address the need for clearer and more predictable standards for classifying third-party beneficiary contracts would be to impose heightened pleading requirements. *See* AOB–42. At a minimum, Plaintiff should be required to plead how the intent to benefit the third party was manifested. Clear intent requires more than referencing the foreseeable benefits associated with contract performance and how those benefits flow to some extent to third parties.[14]

The intent to benefit requirement of a third-party creditor beneficiary contract is not satisfied in this case.

## VI. A QUALIFYING THIRD-PARTY CREDITOR BENEFICIARY CONTRACT *HAS A PRINCIPAL PURPOSE* OF DISCHARGING AN OBLIGATION THE PROMISOR OWES TO A THIRD PARTY; THE ALTOUR-ADP CONTRACT DOES NOT MEET THIS PRINCIPAL PURPOSE REQUIREMENT

Another workable and predictable way to identify third-party creditor beneficiary contracts—and differentiate them from other contracts—is by undertaking

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[13] Examples include accountants, attorneys, security services, actuaries and employee benefit consultants (to name a few).

[14] Plaintiffs ought not to be able to create claims based on fictional allegations that conflict with facts like "Plaintiff herself[] confirmed that she regularly did not timely report her overtime." *See* accompanying RJN request.

a principal purpose inquiry. Plaintiff claims such an inquiry is unwarranted and should apply (if at all) only in the context of legal malpractice cases that involve (in Plaintiff's view) "sharply circumscribed rules for liability." RB–17. Plaintiff also claims that two older court of appeal cases are inconsistent with using a "primary" or "principal" purpose requirement to workably and predictably identify third-party creditor beneficiary contracts. *See* RB–17, citing *Stanton v. Santa Ana Sugar Co.* (1927) 84 Cal.App. 206, 209; *Miles v. Miles* (1926) 77 Cal.App. 219, 228. Wrong again.

First, Plaintiff cites no support for her assertion that rules governing attorney-client contracts, and duties owed to third parties as a result of attorney-client contracts, are self-contained such that those rules may not be used to identify and define third-party creditor beneficiary rights in other situations. Precedent belies this effort to isolate attorney-client contracts into their own, idiosyncratic world.[15] One of this Court's oft-cited cases is *Lucas*, 56 Cal.2d at 583, which addresses third-party beneficiary rights associated with a lawyer-client engagement agreement. California courts rely on *Lucas* when evaluating other types of contracts that do not involve lawyers and clients.[16]

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[15] Plaintiff claims that ADP's invocation of a principal purpose inquiry as a means to identify third-party creditor beneficiary contracts is not supported by legal authority. RB–17-18. But Plaintiff ineffectually purports to distinguish the case law ADP cites by claiming, for example, that attorney-client contract scenarios are not relevant to establishing third-party beneficiary rights in other contractual settings. *See* AOB–34, citing *Goldberg v. Frey* (1990) 217 Cal.App.3d 1258, 1268-69; RB–17-18.

[16] *See, e.g., Murphy v. Allstate Ins. Co.* (1976) 17 Cal.3d 937, 944; *Martinez*, 11 Cal.3d at 400; *Smith v. Microskills San Diego, L.P.* (2007) 153 Cal.App.4th 892, 898.

Second, the older court of appeal cases Plaintiff cites do not even address—much less undercut—use of a principal purpose inquiry to workably and predictably identify third-party creditor beneficiary contracts. In *Stanton*, 84 Cal.App. at 210, the contract contained multiple promises, one of which was unambiguously intended to benefit a third party. *Stanton* supports the conclusion that one of several provisions in a contract may be clearly intended to benefit a third party. But that does not detract from use of a principal purpose inquiry where, as here, Plaintiff claims to receive derivative benefits as ADP performs its contract with Altour. In that situation, a principal purpose inquiry is needed: Does a promise aimed at benefitting the promisor have as a principal purpose benefitting third parties who receive derivative benefits that result from the promisor's performance? Likewise, in *Miles*, 77 Cal.App. at 228, the court recognized that a third-party creditor beneficiary contract need not be one exclusively for the benefit of one person: "[i]t is sufficient if among the benefits arising from the performance of the agreement, there exists the right sought to be established." *Ibid.* This result does not undercut use of a principal purpose inquiry when derivative benefits allegedly flow to Altour employees as ADP performs for Altour's benefit.

In discussing the principal purpose inquiry, ADP has pointed to Civil Code §2343 and the limits it places on lawsuits against agents when third persons have grievances with the principals for whom the agents act. AOB–33-34. Plaintiff disputes whether payroll service providers do, in fact, have principal-agent relationships with their customer-employers. RB–20-21. She misses the point. Regardless of

whether payroll service providers are viewed as agents or independent contractors of the employers who hire them, "California law embraces the importance of protecting the lines of responsibility associated with service provider relationships like these," AOB–33, and limits direct third-party claims against service providers for that reason. Section 2343 is an example of such a limit. The recognized need for limits on third-party claims against service providers also supports use of a principal purpose inquiry—or other principle(s)— to workably and predictably identify true, third-party beneficiary contacts. However a particular service provider-client relationship is characterized (*i.e.*, agency or independent contractor) services are rendered at the request of the employer for the benefit of the employer; benefits flow to others as the service provider fulfills contract obligations to the employer.[17]

Plaintiff suggests that some unidentified "characterization" ADP has made is unsupported by Plaintiff's complaint and should not be entertained as a pure question of law. RB–18. If this confusing suggestion refers to Plaintiff's pleadings, the inadequacy of those—and the need to carefully scrutinize them—are addressed, *ante*, topic V, and at AOB–27, 42 & n.21. If the suggestion is meant to characterize ADP's principal purpose argument as newly-raised, this case arises on demurrer where the issue is whether Plaintiff has or can allege a third-party beneficiary breach of contract

[17] Interestingly, in her unnecessary digression into whether an agency relationship exists in the payroll service provider context, Plaintiff recognizes that "a principal may not assign nondelegable duties to an agent..." RB–21. That is, of course, consistent with ADP's argument that employer wage-and-hour obligations are nondelegable, such that no third-party beneficiary contract exists when an employer contracts for payroll preparation assistance.

cause of action on any basis. *See* Code of Civil Procedure §472c. Moreover, ADP has long argued the need for courts to vigorously scrutinize whether there is a clear, express intent to benefit the employees of those for whom payroll processing services are performed. *See* 2-AA-124. A principal purpose inquiry is one way to apply the express intent to benefit test in order to achieve principled, workable and predictable results.

## VII. MANY CONSIDERATIONS CUT AGAINST ENDORSING THE CAUSES OF ACTION SANCTIONED BY THE COURT OF APPEAL

In responding to the dramatically broadened liability that would result under the rule she advocates, Plaintiff takes a "so be it" or "let the chips fall where they may" attitude. RB–16-17. But in fashioning common law principles—like rules governing the extent of third-party beneficiary contract enforcement rights—this Court can and should evaluate the public policy implications of the rules under consideration. *See, e.g., Sheldon Appel Co. v. Albert & Oliker* (1989) 47 Cal.3d 863, 873 (weighing public policy considerations before declining to expand tort liability).

Plaintiff suggests the Court should await statistics or legislative action. RB–22-23. But the Legislature has already considered and defined those who are responsible for violation of rights created by the Labor Code and the Wage Orders. *See, ante*, topic III. This legislative action counsels against judicial creation of additional remedies and liabilities. If this Court thinks it should await more information or further legislative action, then now is not the time to broaden third-party beneficiary rights and upset a system of wage-and-hour enforcement that has worked well to date.

Plaintiff claims the focus of any public policy examination should be on the purposes of California laws requiring payment of wages and delivery of accurate wage statements. RB–22. Plaintiff emphasizes that IWC Orders were enacted to curb abusive employer activity and that, in recognizing whether a duty of care should be recognized under the tort of negligence, an important factor is assuring accurate and compliant wage payments. RB–22-23, 27. But those important policies are fulfilled by the duties imposed on employers. The importance of those policies is all the more reason to fix compliance responsibilities that are clear and free of debate. Moreover, when—as here—strong public policies support particular statutory duties, that is a reason to make the duties nondelegable. AOB–18-19.

Employers and payroll service providers alike already have ample incentives to do their work accurately under existing law, based on the existing liabilities they face. No one is suggesting that payroll service providers are or ever have been "immune." RB–23.

Plaintiff concedes that existing law allows employers to sue payroll service providers in response to complaints they face from their employees. RB–27. Plaintiff concedes such suits are rare and sees collusion in the lack of litigation. RB–24-25. She also conjures "overly cozy relationship[s]" between payroll service providers and employers..." RB–28. The rational conclusion is that the law's existing assignment of responsibilities protects worker rights and sorts out employer-payroll service provider responsibilities in a well-functioning manner. The absence of litigation strongly suggests the absence of problems.

Plaintiff claims that, because payroll service providers already face contract liabilities toward employer-clients, additional liabilities will not be significant. RB–27-28. Not so. Adding payroll service providers to California's burgeoning explosion of wage-and-hour litigation will dramatically expand the number of claims they face, complicate wage-and-hour suits with a needless layer of additional claims, and dilute worker protection by undercutting the predominant role of the employer's nondelegable duties.

The Legislature has created powerful enforcement remedies aimed only at employers and a limited number of others—a universe that does not include payroll service providers. These remedies include government enforcement actions, private-party PAGA enforcement on behalf of the state, private civil enforcement by employees in some instances and potential unfair competition law claims as to wages owed. AOB–16-21. This arsenal of enforcement remedies fosters the policies underlying the Labor Code and the Wage Order provisions applicable to overtime pay and wage statements.

Far from increasing the incidents of accurate wage payments, RB–23, additional, redundant causes of action may actually dilute wage-and-hour enforcement. Given the important public policies at issue, the object ought to be to promptly get appropriate compensation into the hands of workers and not to have them face multiple disputants disclaiming personal responsibility as to some paycheck shortfall or compliance issue. Even as to employers that rely heavily on payroll service providers, it is the employer who is best—and singularly—situated to assure wage-

and-hour compliance because accurate payroll preparation is heavily dependent on the data the employer generates and maintains. The result of Plaintiff's trial against her employer vividly proves the point.

Plaintiff cynically suggests that, without the causes of action created by the court of appeal, employers may seek out incompetent payroll service providers in order to gain financial benefits. RB–24. But that counter-intuitive speculation, even if true, is all the more reason why employers should not be allowed to delegate their obligations and use that delegation to skirt their responsibilities.

Plaintiff suggests that the rule created by the court of appeal will be useful in cases "where an employer is financially troubled." RB–23. But even under the theories of liability created by the court of appeal, payroll service providers ought not be liable to pay the wages that employees earned by providing their labor to the employer-clients of payroll service providers. Payroll service providers are not guarantors of employer debts or wage liabilities.

Plaintiff cites Civil Code §1714, defining the tort of negligence, and various maxims in the Civil Code, addressed to negligence and allocating responsibility for injurious conduct. RB–26. But parties to a contract are entitled to define the rights and obligations they create, not have them implied or derived by judicial fiat. *See, e.g.*, Civil Code §1636.

Public policy considerations favor reversal of the court of appeal's decision.

## VIII. THIS CASE PRESENTS IMPORTANT OPPORTUNITIES TO REFINE THE PRINCIPLES USED TO IDENTIFY THIRD-PARTY BENEFICIARY CONTRACTS

Plaintiff says little about the various ways in which more workable and predictable standards could be brought to the issue of whether a third-party beneficiary contract truly exists. ADP's suggestions—drawn from extensive scholarly commentary—stand largely unrefuted. See AOB–39-43.

Plaintiff claims she would qualify for third-party beneficiary status under the SECOND RESTATEMENT OF CONTRACTS, §302, which envisions situations where contracts are designed to "satisfy an obligation of the beneficiary [sic] to pay money to the beneficiary..." RB–25. But payroll service providers do not pay the wages of their clients' employees. They facilitate proper wage payments by their client-employers. The Second Restatement provision Plaintiff invokes is focused on situations where, as part of the consideration for a contract, the promisor agrees to pay out of its own funds money the promisee owes to a third party. Restatement (Second) of Contracts § 302(1)(a) & cmt. b (1981). That scenario cannot be extended to classifying employees as third-party beneficiaries of their employers' payroll service contracts.

Plaintiff questions whether an employer should be held liable for underpaid wages when a payroll service provider causes the underpayment. RB–25. But Plaintiff again overlooks that payroll service providers do not pay wages; they facilitate employer payments. If a payroll service provider miscalculates wages, that

does not change the fact that the employer is the only one that benefits from the labor performed and is responsible to pay for it.[18]

* * *

Employees are not third-party beneficiaries of their employer's payroll service contracts. This Court should reach that conclusion by applying existing principles or by bringing added clarity to California law governing third-party beneficiary contracts.

## IX. THE RECOGNITION OF A CAUSE OF ACTION FOR NEGLIGENCE IS UNWARRANTED

As with her views on breach of contract liability, Plaintiff advocates a sweepingly broad analysis for the tort of negligence that would subject service providers to liability that is greater than that of their clients (tort liability in addition to contract liability). Plaintiff also advocates broad duties of care that exceed any warranted under existing precedent. No negligence cause of action should be created.

Plaintiff suggests the court of appeal properly found a duty of care under *Biakanja v. Irving* (1958) 49 Cal.2d 647, on the basis that, if ADP made payroll calculation mistakes, Plaintiff did not receive all wages owed to her, and employees need timely-paid wages. RB–29. Plaintiff theorizes that, if a wage shortfall is in some

[18] Plaintiff makes a cryptic reference to "equitable contribution," RB–26, without explaining why it would defeat a payroll service provider's right to seek reimbursement from an employer if required to pay an employee's previously unpaid wages. Equitable contribution adjusts rights between co-obligors as to a loss. *Fireman's Fund Ins. Co. v. Maryland Casualty Ins.* (1998) 21 Cal.App.4th 1586, 1595-1596. Payroll service providers are not co-obligors for the wages of their employer-clients.

way attributable to ADP, Plaintiff is foreseeably harmed and, consequently, a duty supporting a negligence cause of action should be recognized.

This flawed analysis overlooks that "there are clear judicial days on which a court can foresee forever and thus determine liability but none on which that foresight alone provides a socially and judicially acceptable limit on recovery of damages for [an] injury." *Thing v. La Chusa* (1989) 48 Cal.3d 644, 668. Foreseeability of harm is not enough to impose a duty. *Nally v. Grace Community Church* (1988) 47 Cal.3d 278, 297. Plaintiff would create a tort duty based on the idea that payroll miscalculations foreseeably injure employees, despite the mechanisms in place to ensure that employers pay wages in a timely and proper fashion.

In addressing the *Biakanja* factors, 47 Cal.2d at 650, Plaintiff speaks to only three of them: foreseeability of harm, moral blame and the policy of preventing future harm. Her analysis of each ultimately ties back to foreseeability: if a payroll service provider miscalculates wages, that harms employees of the payroll service provider's clients. But that analysis is flawed, because there is no foreseeability of harm: the employer retains the duty to pay.

Plaintiff's entire *Biakanja* analysis erroneously brushes off the importance of the employers' role. The issue here is whether public policy considerations favor creating payroll service provider liabilities even though employers have established duties to assure proper payment of employee wages. This is not a situation where the *Biakanja* analysis will determine whether harm will be redressed *at all*. Under current law, employers redress any employee harm. The *Biakanja* factors do not favor

recognizing additional remedies based on allegations of the negligent rendition of services under an employer-payroll service provider contract. This result does not mean service providers escape responsibility. Employers may pursue their payroll service contract remedies, and they face loss of patronage if their work exposes employer-customers to significant liabilities for wage payment errors.

Plaintiff suggests—for the first time—that a claim for negligent interference with contract might lie against ADP. RB–29-30. Plaintiff doesn't explain her cryptic suggestion or show how such a claim could be made out based on the elements of the interference tort. What Plaintiff's suggestion shows is how recognition of a tort duty will likely spawn still other, far-fetched liability theories.

Plaintiff says ADP has argued it lacks expertise in providing payroll assistance. RB–30-31. That's false. ADP pointed out that professional negligence claims are associated with professions as to which—unlike here—statutes, regulations, rules or licensing impose duties. *See* AOB–43-44 & n.23. Plaintiff again misses the point. New duties—particularly new tort duties growing out of contract relationships—are unwarranted unless public policy strongly favors such a result. Here, existing remedies protect workers. There is no reason to recognize additional remedies or impose tort liability based on alleged malpractice under a contract that does not arise in the context of a traditional profession.

In responding to ADP's argument that contract claims cannot be recast as tort causes of action, Plaintiff invents her own version of the law and invites the Court to ignore the contract obligations and assess whether a tort duty is owed. RB–33. But

contract obligations cannot be ignored: a tort duty and cause of action should not be recognized unless it is completely independent of the contract. *Erlich v. Menezes* (1999) 21 Cal.4th 543, 552. Here, payroll service provider work is pursuant to contract with the employer. The alleged negligence is not completely independent of the contract: it is based on how the payroll service provider performs under the contract. The issue is not whether facts supporting potential contract and tort causes of action are mutually exclusive. RB–33. The claims must be completely independent; and here they are not. Absent that independence, necessary demarcation lines between contract tort remedies are unacceptably blurred if tort remedies are authorized.

Plaintiff suggests courts should conduct parallel inquiries into whether third-party beneficiary rights and *Biakanja*-based tort duties exist, and sanction whatever causes of action emerge from such a parallel analysis. RB–33-34. But Plaintiff cites no precedent for such an inquiry. Plaintiff also fails to coherently articulate how such a parallel analysis would account for recognized limits on tort claims arising from contract relationships. The *Biakanja* factors predate many of the cases that limit contract-related tort claims.

With respect to the economic loss rule as a restriction on negligence claims, AOB–48-49, Plaintiff claims she suffered emotional distress without suggesting how that generates recoverable damages for underpaid overtime wages or defective wage statements. RB–35-36. Plaintiff suggests she may have a claim for negligent interference with prospective advantage, RB–36, a claim she has never before asserted, and

as to which she makes no effort to explain either the elements of such a cause of action, or how they could be alleged here.

No negligence cause of action is justified here.

## X. THE RECOGNITION OF A CAUSE OF ACTION FOR NEGLIGENT MISREPRESENTATION IS UNWARRANTED

Plaintiff fares no better trying to justify her cause of action for negligent misrepresentation. Recognition of this claim would be particularly pernicious since, under Plaintiff's theory, such a claim would arise whenever any mistake was made in a wage statement. Such a cause of action is also subject to the limits on imposing tort liability for contract breaches. As a negligence-based theory of liability, the economic loss rule should apply to it too. *See* AOB–49-50.

Plaintiff claims ADP has not cited this Court's precedent in support of its arguments. RB–37. False. ADP cross-referenced its earlier invocation of this Court's precedent, AOB–49-50, restricting tort remedies in contract settings and restricting the recovery of economic losses under negligence-based causes of action. Plaintiff acknowledges the federal authority ADP invoked, RB–37, but she fails to effectively distinguish it. It does not matter whether that authority actually involves employment law scenarios, RB–37.

Plaintiff claims there is a special relationship exception to the economic loss doctrine that ADP should have addressed. RB–38. But ADP addressed it, noting that the court of appeal found a special relationship based on the existence of the third-party creditor beneficiary status it conferred on Plaintiff. AOB–14. ADP also pointed

out that, if Plaintiff is not a third-party beneficiary, "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." AOB–50 (citation omitted).

Moreover, Plaintiff relies for this supposed "special relationship" exception on *J'Aire Corp. v. Gregory* (1979) 24 Cal.3d 799, 804. *J'Aire* was concerned with whether a restaurant tenant could recover lost profits based on a contractor negligently breaching a construction contract with the restaurant's landlord. *J'Aire* has nothing to do with whether a party claiming third-party beneficiary rights derived from a contract may seek damages based on economic losses or other non-contract theories via a negligence-based claim.

Plaintiff disputes the application of cases like *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 376, and the limits they counsel on the creation of negligence-based liability. Plaintiff claims the liabilities payroll service providers would face under negligence-based theories are not as great as those accountants faced in *Bily*. Plaintiff also claims wage statements are not like the reports and opinions provided by the accountant in *Bily*. RB–39.

This is all of no moment. The liabilities Plaintiff would impose broadly extend to all employees of all employer-clients of payroll service providers. According to Plaintiff, those liabilities would include paying wage shortfalls owed to the employees of payroll service provider clients.

Moreover, and more importantly, payroll service providers are, like the accountants in *Bily*, dependent on information supplied by others. Their work requires that they be given accurate time and wage data. Their work is ministerial, based on data that is controlled and provided by others. That makes them like the accountants in *Bily*. Creating broad liabilities based on factors over which payroll service providers have limited control is altogether unwarranted.

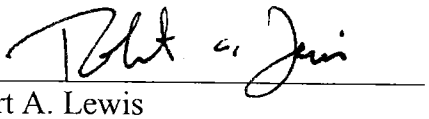
## XI. CONCLUSION

The judgment of the court of appeal should be reversed.

Dated: June 20, 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 8,336 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: June 20, 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 June 20, 2017, I caused the following document to be served:

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Second Appellate District, Division 4
300 S. Spring Street
North Tower – Second Floor
Los Angeles, CA 90013

Honorable William Barry
Los Angeles County Superior Court
200 West Compton Boulevard
Compton, CA 90220

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 June 20, 2017, at San Francisco, California.

By: D. Kim
Davace Chin

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