

CALIFORNIA EMPLOYMENT LAWYER

ADVISOR TO EMPLOYERS AND EMPLOYEES

AN EMPLOYEE CANNOT SUE THE EMPLOYER'S PAYROLL COMPANY FOR MISTAKES CAUSING WAGE AND HOUR VIOLATIONS. THE ACTION MAY BE BROUGHT ONLY AGAINST THE EMPLOYER.

February 8, 2019

Under the California Labor Code, an employee may file a civil action in the California Superior Court, federal court (if jurisdiction exists), or in a California Labor Commissioner action against the employer for non-payment of wages, including hourly wages, salary, commissions, minimum wages, overtime pay, accrued but unused vacation pay, and other compensation. (Cal. Lab. Code, §§ 98, 218.5, 227.3, 1194, 2699.)

In *Goonewardene v. ADP, LLC* (2019) 5 Cal.5th 154, Plaintiff Sharmalee Goonewardene, a Sri Lankan national, filed a civil action against her employer, Altour International, Inc. (Altour), and the employer's payroll company, ADP LLC, for unpaid wages.

Litigating the case against payroll company ADP under creative legal theories, when the case reached the California Supreme Court, it framed the issue as whether an employee could maintain a civil action against an independent payroll service which was hired by the employer to process payroll (e.g., calculating wages, deductions, hours, vacation time, etc.) that would otherwise be handled by the employer's internal payroll department. The Court held: (1) Plaintiff could not maintain a breach of contract action against the payroll company under a third party beneficiary theory for breach of the payroll company's oral contract with the employer, and plaintiff's cause of action for (2) negligence and (3) negligent misrepresentation failed because the payroll company had no legal duty of care to the employee third party.

Third Party Beneficiary Theory: Plaintiff's case against the payroll company under a third party beneficiary theory (hereinafter referred to as "TPB") failed, the Court held, because a third party individual or entity may only bring a breach of contract action if the third party (here, plaintiff) can establish (a) that it is likely to benefit from the contract, (b) that a motivating purpose of the contracting parties is to provide a

benefit to the third party, and (c) that the action is consistent with the objectives of the contract and the reasonable expectations of the contracting parties.

Acknowledging that the contract would generally benefit plaintiff Goonewardene, the Court reasoned that the motivating purpose was to benefit the employer, not the employee. Explaining that in the classic TPB action, party A contracts with B for A to pay B's debt to C. If A fails to pay the B's debt, C may maintain a breach of contract action against A as a TPB of the A-B contract. Contrasting plaintiff's TPB claim to the seminal California TPB case, *Lucas v. Hamm* (1961) 56 Cal.2d 583, the Court explained that the intended beneficiaries of a will, who failed to receive their inheritance because of the drafting attorney's negligence, were entitled to sue the attorney as third party beneficiaries, because the main purpose of the testator-attorney contract was to benefit the persons named in the will. The only way to effectuate the contracting parties' intent, the Court concluded, was to permit the beneficiaries to sue the attorney.

Distinguishing *Goonewardene* from TPB cases, the motivating purpose of the contract was to benefit the employer by streamlining payroll efficiency and cost, and not to directly benefit employees. Furthermore, permitting recovery would be inconsistent with the objectives of the contract and reasonable expectations of contracting parties ADP and Altour. Noteworthy in the decision was the recognition that allowing TPB lawsuits would increase employer costs, as a payroll company would have to increase prices to safeguard against TPB claims. Furthermore, unlike the plaintiffs in *Lucas v. Hamm*, Altour was fully capable of suing ADP directly if ADP breached its contractual obligations, permitting employees to sue ADP would not effectuate the objectives of the ADP-Altour contract, and plaintiff Goonewardene was protected because of her right to file a wage and hour case against her employer.

Negligence: The Court examined its precedents in *Rowland v. Christian* (1968) 69 Cal.2d 108 and *Biakanja v. Irving* (1958) 49 Cal.2d 647 to determine whether a legal duty of care existed between ADP and third party employees. Noting the various factors to be balanced in deciding whether a tort duty of care existed toward a third party in the absence of privity of contract, the Court considered (a) the extent to which the transaction was intended to affect the party, (b) the foreseeability of harm, (c) the degree of certainty that the party suffered injury, (d) the closeness of connection between a defendant's conduct and the injury

suffered, (e) the moral blame attached to the defendant's conduct, and (f) the policy of preventing future harm.

Recognizing the policy considerations of imposing tort liability, the Court held that ADP had no legal duty of care to the plaintiff. She had the statutory right to file a wage claim against her employer and imposing a separate duty of care on the payroll company would be unnecessary to further protect plaintiff's interests. Moreover, tort liability would not be necessary to deter the payroll company's negligent conduct as it is already contractually bound to act with due care under its contract to correctly perform payroll functions. Further, utilizing its TPB analysis, the Court noted that no "special relationship" existed between the payroll company and the third party employees. In similar situations, no tort duty has been found to exist where a breach of contract led to the economic loss of a third party. Finally, imposition of a tort duty would, the Court feared, open the flood gates to wage and hour litigation.

Negligence Misrepresentation: The same policy considerations under a negligence theory were applicable to a cause of action for negligent misrepresentation. Examining *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, wherein a third party was permitted to sue an auditor for negligent misrepresentation in the preparation of an audit of a client's financial statements, the Court distinguished *Bily* because the third party users of the audit reports were intended beneficiaries known to the auditor for whose benefit the audit report was issued. The ADT-Altour contract, the Court concluded, was not entered into for the benefit of plaintiff or other employees and plaintiff was not an intended beneficiary of ADP's services.

Significance of the Case for Employees:

No employee rights have been restricted or denied. A favorable decision for plaintiff Goonewardene would have expanded employee rights. Employees may still file civil wage and hour claims in the Superior Court, federal court if there is jurisdiction, and with the California Labor Commissioner.

Significance of the Case for Employers:

Employers must make sure their payroll companies are correctly calculating payroll. Although the payroll company is not liable to third party employees, an employer may sue the payroll company for payroll

errors. However, regardless of which entity made the mistake - employer or payroll company - the danger to an employer is that even minor payroll miscalculations may lead to substantial damage claims against the employer. Wage and hour cases are often referred to as "low hanging fruit" because of how complicated wage and hour law is and how easy it is to make occur. Labor Commissioner cases have been called "time bombs" because any slight error, unless corrected immediately, can lead to substantial damages and penalties that may involve one or two employees or an entire work force, and with practically no "discovery" permitted in Labor Commissioner actions, a 10-day window to appeal to the superior court, and full payment of the Labor Commissioner Award or bond for the full Award at time of filing the appeal, the Labor Commissioner - with its initial settlement conference and often summary trial - poses a substantial risk for employers.

Kenneth J. Sargoy, Esq. provides counseling and legal representation for employment and business cases in California state and federal courts and government agencies. Questions should be directed to Ken at telephone (310) 208-1003, (310) 472-7113 or to his email at ken@sargoyle.com. The office is located at 815 Moraga Drive, Third Floor, Los Angeles, CA 90049.

NOTE: The Sargoy Law Newsletter is designed to provide general information. It is not intended to, nor does it, offer solutions to individual problems. Persons having specific questions should contact legal counsel for professional advice. THE SARGOY LAW NEWSLETTER IS CONSIDERED ADVERTISING MATERIAL UNDER APPLICABLE RULES OF PROFESSIONAL CONDUCT.